

DOD FINANCIAL MANAGEMENT

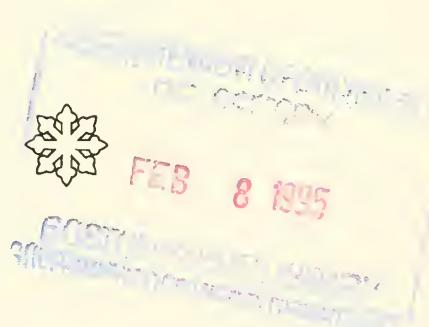
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DOD Financial Management, S. Hrg. 10...

HEARING BEFORE THE COMMITTEE ON GOVERNMENTAL AFFAIRS UNITED STATES SENATE ONE HUNDRED THIRD CONGRESS SECOND SESSION

APRIL 12, 1994

Printed for the use of the Committee on Governmental Affairs



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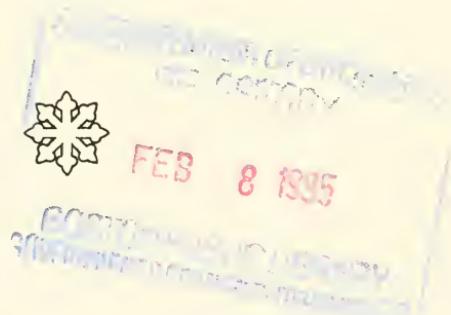
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DEPARTMENT OF DEFENSE FINANCIAL MANAGEMENT

TUESDAY, APRIL 12, 1994

**U.S. SENATE,
COMMITTEE ON GOVERNMENTAL AFFAIRS,
*Washington, DC.***

The Committee met, pursuant to notice, at 9:34 a.m. in room SD-342, Dirksen Senate Office Building, Hon. John Glenn, Chairman of the Committee, presiding.

Present: Senators Glenn, Dorgan, and Cohen.

OPENING STATEMENT OF SENATOR GLENN

Chairman GLENN. The hearing will be in order. Good morning. Today, the Governmental Affairs Committee meets to examine progress made by the Defense Department in improving its financial management practices and systems. Now, this sound like a topic that could empty this room or any other room around here in a big hurry, probably, but whether or not the Pentagon makes progress in this area has an enormous impact on how the Government operates and on how Americans view their Government. We are talking many, many tens upon tens of billions of dollars. We all fuss over something in the budget that involves smaller amounts of money, and we should, but on the efficiency or the follow-up of how that money gets spent, we have been all too lax for too many years.

We all know that over the years stories of Pentagon waste and fraud and abuse have given Americans a rather negative view of how their tax dollars are spent. Unfortunately, today's hearing is not going to improve that image very much, I am afraid. This Committee has held many hearings over the years on how the Defense Department was managing its inventory, controlling its assets and accounting for tax dollars.

We have passed laws out of this Committee, like the Inspector General Act and the Chief Financial Officers Act to improve those areas across Government, including the Defense Department. So, now, Congress and the public can get a clearer understanding of how agencies are managing and spending their money. In all candor, I must say that until recently those hearings were often an exercise in futility. It was too often like sailing paper airplanes off in the Grand Canyon. People would sit in this room, promise action, and those actions would vanish without a trace.

I have been pleasantly surprised, however, with changes made in the last few months. While we have not even begun to turn the corner on the complex and often daunting financial management prob-

lems at the Pentagon, I am encouraged by the emphasis that the leadership of the Department is giving to these important issues. For years, the Pentagon spent its time downplaying both the importance of financial management and the scope of the problems themselves; never mind trying to solve them.

Today, on issues of financial accountability and stewardship, we see a refreshing candor coming out of the Pentagon, a great deal of energy and initiative on the part of people like Defense Secretary Perry and Comptroller Hamre who are trying to get a handle on these problems and find solutions that work. Obviously, many of these problems have been festering for years, even decades. As I think they know already, the new leaders have inherited a culture of neglect, as did leaders before them, as did leaders before them, as did leaders before them.

Make no mistake, fixing Defense financial management problems will not be easy, even when you have leadership that is committed to doing it. If nothing else, the audit work being presented here this morning by the General Accounting Office and the Pentagon Inspector General confirms just how extensive these problems remain. Just a few examples will prove my point.

At our hearing on Defense financial management last July, the GAO revealed that contractors had returned to the Government \$751 million in overpayments for the first 6 months of fiscal 1993. That number has since increased to \$1.4 billion for the first 9 months of fiscal 1993. These were payments for which contractors had never sent a bill—\$1.4 billion.

At that hearing, the Pentagon assured us that those payments were the result of issued demand letters—in other words, that they knew about these overpayments and were recovering them—but the GAO report that we are releasing this morning shows that in almost every case examined the contractor told the Government about the overpayment. GAO is now doing follow-up work for the Committee and asking a very important question: how much is owed the Government in overpayments that contractors have not returned and that we haven't found yet?

Another example: Last July, as part of the first ever audit of the Army, as required under the CFO Act, GAO told the Committee that the Army had overpaid by \$6 million some 2,200 soldiers, including deserters, prisoners, and ghosts who were created through fraud by people with access to payroll and personnel systems. This morning, the GAO tells us that while some progress has been made to tighten up these systems, further investigation has found that the Army sent out about \$8 million in unauthorized pay, that 76 deserters continued to receive pay after they went AWOL, and six ghosts were created by four employees. I would note with some incredulity that one of these ghosts had a rather good career in the Army. He was deployed to Southwest Asia and promoted six ranks to sergeant first class.

In the payroll area, I am also concerned with the impact of some mistakes made by DFAS, the Defense Finance and Accounting Service, in its efforts to comply with a Congressional directive for giving Desert Shield/Desert Storm veterans from certain debts. The Inspector General tells us that DFAS in many cases forgave the wrong soldiers and the wrong debts, including debts due to fraud

and misrepresentation. About 75 percent of the debts forgiven by one DFAS finance center were to the wrong soldiers and the wrong debts—\$15 million of the \$21 million that they forgave.

One final example is the extensive problem the Pentagon has with paying its bills. Recent audit work done by the GAO and the IG indicates that the Defense Department has between \$32 and \$41 billion in what are called unmatched disbursements, which means that checks have been written without first being matched to bills. It is as if you and I paid our credit card bill without first seeing what the charges were for. In my opinion, this is unacceptable, and it is no wonder that, as a result, we continue to see some crazy cases of fraud.

Just recently, a former Navy Sealift employee pled guilty to stealing \$3 million over a 4-year period of time. He submitted 114 invoices for machinery parts that were never delivered, and the Navy and DFAS paid 108 of them. They even told him how to fill out the paperwork.

Unfortunately, we could go on and on with examples, but the bottom line is there is a lot of work to be done at the Pentagon that has needed to be done for a long, long time and through many administrations. This neglect also means that many of the hundreds of information systems at the Pentagon are in desperate need of overhaul and consolidation. We are releasing a second GAO report this morning which shows that progress in the Corporate Information Management initiative, the CIM, designed to streamline and reengineer these systems, has met with only limited success. We have been putting a lot of emphasis on that and have been relying on that to straighten out a lot of things, but it has so far met with only limited success.

Besides the waste, fraud and abuse that continue every day, the financial problems are not fixed and the systems are not overhauled. Now, I am worried that our good-intentioned leadership at the Pentagon will not stick around. You know, the average tenure of political appointees in Government isn't very long; 30 percent are gone in 18 months and 50 percent within 27 months of the political appointees in Government that are supposed to implement the policies. Then we will be back to business, or should I say bad business, as usual.

And so while I applaud the first steps that the Pentagon is taking—and they are very important steps, but they are first steps—what I am hearing from the GAO and the IG leaves me a bit dismayed about the Defense Department's progress in financial management. From the beginning of the CFO Act and even before it, this Committee has played an important role in strengthening the Government's financial stewardship, and we will continue to do so. That stewardship is critical to an efficient, effective and credible Government.

I want to welcome our witnesses here this morning. First, we will hear from Senator Grassley, who shares this Committee's concerns about financial management progress at the Pentagon. He has been active in these areas for a number of years. We are glad to welcome him for his testimony at the Committee this morning. He had legislation on the floor during the Defense authorization last year. We had a debate on some of his concerns at that time, and

so although he is not a member of this Committee, we certainly welcome his testimony because he has been interested in this area for a long time.

Then we will have Charles Bowsher, Comptroller General of the United States, head of the General Accounting Office and a frequent witness before this Committee. He will discuss the two reports we are releasing this morning and give us his impressions of progress at the Pentagon.

He will be followed by Derek Vander Schaaf, Acting Inspector General of the Department of Defense, who in the last month has released several quite critical reports on financial management, and he will summarize those for us today. Finally, and certainly a key player in this, we will hear from John Hamre, the Comptroller and CFO of the Department of Defense, who I hope will share with us his plans for strengthening the Pentagon's financial management.

Senator Cohen?

OPENING STATEMENT OF SENATOR COHEN

Senator COHEN. Thank you, Mr. Chairman. I have a fairly lengthy statement which I think only replicates what you have already stated, so I would submit that for the record and perhaps just offer a couple of comments.

Chairman GLENN. It will be put in the record.

PREPARED STATEMENT OF SENATOR COHEN

Mr. Chairman, I am pleased to be able to participate in today's hearing to examine the financial management problems that plague the Department of Defense (DOD). I look forward to hearing how the Defense Department intends to better meet its obligations of improving its financial management systems as Congress, and specifically this Committee, intended as part of the Chief Financial Officers (CFO) Act of 1990.

As the Chairman well knows, these are long-standing problems. The General Accounting Office (GAO) has issued numerous reports over the years outlining the Defense Department's financial management problems. The DOD Inspector General and the military services' audit organizations have conducted a number of financial audits of DOD entities which have also identified financial management problems, and this Committee has held several hearings to examine these issues over the last few years.

Despite these efforts, widespread problems in DOD's financial management operations and controls continue to exist. We are going to hear today about payroll errors, contractor overpayments, unmatched disbursements, and outright fraud at DOD. We are going to hear how the Department's lax internal controls enabled one individual to steal roughly \$3 million and use these funds to purchase homes and expensive cars.

Mr. Chairman, I am troubled by the fact that in addition to stealth bombers we now have "phantom" soldiers. Holograms made possible at the taxpayers' expense are the result of DOD's lax financial management operations. We will hear about a finance clerk who manipulated the payroll system by establishing pay accounts for two fictitious soldiers. More than \$33,000 in payroll payments went to the clerk's bank account in Germany for two non-existent soldiers.

Another finance clerk obtained a list of separated soldiers from the payroll system and reactivated a former soldier's pay account. Pay disbursements were deposited directly into the clerk's account at a financial institution in New Hampshire. Not only was this "phantom" employee paid over \$8,600 erroneously by DOD, but he was promoted and his enlistment time was extended until 1997.

We are also going to hear how deserters and military personnel who separated from the military continued to be paid by DOD. The GAO will cite many examples today where these individuals received tens of thousands of dollars each in erroneous payments.

I am very concerned by the fact that last July, I sat here, as did the Chairman, and heard about a number of the very same problems we are going to hear about today. It appears that DOD has not come very far in the 9 months since that hearing took place. Waste, fraud, and mismanagement remain rampant within DOD and millions of taxpayers' dollars are being squandered.

The military base closings that are occurring around the country are having a devastating effect on local economies. In Maine, 8.2 percent of the State's workforce (55,000 employees) is employed in defense-related work. The earnings of these employees is \$1.4 billion, which represents 10 percent of the State's workforce. The closure of Loring Air Force Base in September is going to place significant economic hardships on the people of Maine who have already been hit hard during these difficult economic times. As our military engages in its downsizing effort, and defense spending is reduced over the next few years, it will be increasingly important for DOD to ensure that the taxpayers' dollars it consumes are spent wisely.

These are certainly not ordinary times. The Federal Government is asking all Americans to share in the burden of trying to reduce the Federal budget deficit which is threatening our children's futures. The people of Maine and other States are willing to do their share, but they want their government to do its part and cut spending. The American people are pleading with their government to get its fiscal house in order and examples of the waste, fraud, and abuse that we are going to hear today only illustrate that the government, to date, has yet to live up to the task.

Americans are outraged, and justifiably so, when they read about wasteful government spending. They are suspicious of a government that asks more of them in its efforts to reduce the deficit, while at the same time reading headlines of waste and abuse involving taxpayers' dollars.

During the Committee's hearing last July, we heard about how an Air Force accountant illegally diverted an estimated \$2 million of Air Force funds over a 3-year period to his personal bank accounts. This case demonstrates how the Air Force's internal controls failed to detect and prevent the accountant's activities. It took a neighbor's tip to the Drug Enforcement Agency, believing that his lavish lifestyle was the result of drug peddling, to prompt an investigation which resulted in his arrest and conviction.

Earlier this year, we read reports of a former Navy Sealift Command supply officer who stole \$3 million from DOD over a 4 year period. He sent the Navy Sealift Command 114 bogus invoices for machinery parts that were never delivered. DOD sent 108 checks to a post office box in Norfolk, Virginia. The fraud was discovered only after the ex-serviceman made the mistake of billing for parts supposedly delivered to ships that had been decommissioned. Clearly, DOD's lax internal controls continue to invite theft and fraud.

The DOD IG issued a report last December on the Defense Financial Accounting Service's (DFAS) debt cancellation errors related to Desert Shield/Storm. DOD's 1992 appropriations bill allowed the cancellation of a service member's debt, up to \$2,500, if incurred in connection with the Persian Gulf operation. DFAS centers issued about 127,000 refunds and cancellations valued at \$47 million. However, 31 percent of the debts identified and cancelled did not meet the requirements of the law. Unauthorized debts cancelled included those resulting from dishonored checks, fines and forfeitures, as well as overpayments caused by fraud or misrepresentation. At DFAS-Indianapolis, alone, \$15 million of the \$20 million in cancellations for active duty Army personnel was not authorized and should be recovered. The IG recommended that DFAS identify and correct erroneous cancellations and refunds; however, DFAS claims that actions would be too labor intensive and costly. I would submit that it is proving quite costly to do nothing. How many millions of dollars is DOD willing to see wasted before it takes steps to adequately address this problem?

At last July's hearing, GAO revealed that DFAS had received about \$751 million from contractors during the first 6 months of fiscal year 1993 in overpayments including \$478 million of unsolicited, voluntary refunds for overpayments. Perhaps we should be grateful that honest contractors knock on the Federal Government's door and return the money that DOD has erroneously sent to them. But how many not so honest contractors are pocketing DOD funds at the expense of law abiding taxpayers? I look forward to hearing today what steps DOD has taken to address this problem.

Financial management issues are on the minds of most Americans this week as they finish preparing their income tax returns. The Internal Revenue Service requires taxpayers to keep excruciatingly detailed financial records and yet the Federal Government fails to keep its own records in order. The gross examples of mismanagement and abuse that I refer to in my statement, as well as the countless

others we will hear about from today's witnesses, undermine our government's credibility and underscore our failure to safeguard taxpayers' assets.

Mr. Chairman, let me conclude my statement by saying that the Federal Government has a responsibility to conduct better oversight of its financial management systems to ensure that taxpayers' dollars are not being misused. While I am aware that the Department of Defense has made some changes in an effort to begin to correct these problems, it is clear that it has not done enough. In view of the numerous GAO reports, DOD IG audits, and Committee hearings on these very serious problems, I am losing patience with the lip service that we appear to be getting from DOD. How many times do we have to point to egregious examples of waste and fraud that are so prevalent within DOD before the Department begins to take these problems seriously? How long do we have to wait before DOD initiates the reforms that are necessary to adequately address the Department's financial management problems?

If DOD is unwilling, or unable, to address this deplorable situation, then I stand ready to assist you, Mr. Chairman, in implementing changes so that we are not called back here in another 9 months to hear stories similar to the ones we are going to hear today. I look forward to hearing the testimony from today's witnesses.

Senator COHEN. First of all, I think these hearings are very important. Senator Glenn has demonstrated over and over again that Government oversight is not just a one-shot proposition. We cannot hold a hearing 1 year, or every other year, to find out how our institutions are being managed and then go on to the next issue without any follow-up. It is terribly important that we have this follow-up, and you are to be commended for that, Mr. Chairman.

As you have indicated, these issues are not new. This is Yogi Berra's famous phrase, it is *deja vu* all over again—payroll errors; contractor overpayments; unmatched disbursements; outright fraud; not Stealth bombers, but fantom or fictitious soldiers. We have talked in the past often about having a hollow army, and now we speak not of hollow armies, but perhaps holographic armies. Holograms that appear on the wall of our imagination. Financial clerks are able to reactivate former soldiers' accounts, promote them, enlist them and extend their enlistment. Deserters and those that are separated from military service continue to be paid.

I mention all of this, Mr. Chairman, by way of what is happening with our base closures in this country. We are going through extraordinary times. In my own State of Maine, a major facility scheduled to be closed this year will cause enormous hardship, tremendous economic hardship to many, many people. And we are doing this in the name of saving money because we are being forced to downsize our military, to close facilities, to put people out of work, basically, in order to save money.

When our constituents see the kind of waste, misuse, and mismanagement that takes place in any of our institutions, but particularly the Defense Department, it causes them to question the viability of the system that we have and the support for the system. This comes at a time when we are seeing further and further reductions in our military.

I will leave this hearing shortly to attend two others, one of them being regional conflict. We have the Commandant of the Marine Corps come before the Armed Services Committee and point out that, yes, he has enough to continue to carry out his mission for 1994 and maybe 1995, but beyond that he has got real problems. Beyond that, the question of modernization is called into doubt, the question of sustainability is called into doubt.

So what we are faced with is an ever-diminishing military capability at a time when the people are calling for further reductions, and we are going to see the capability of our military compromised. Public support for continued expenditures on behalf of a strong, ready fighting force is going to be diminished unless we see some substantial changes in what is taking place.

We have another date coming up, April 15, this Friday, and once again as a result of the American people bearing witness to stories which they will find inconceivable, it will decrease the level of their support for funding of necessary programs.

So I think these hearings are very important. I agree with you, Mr. Chairman, that progress has been made as a result of the ventilation of these problems. We have focused public attention on the nature of the vast level of mismanagement that has taken place to date, be it through an absence of modern computers or an absence of a coherent, solidified accounting system. Whatever the rationale, because of those mismanagement problems, we are losing support for something that is very vital to our Nation's defense. So it is important that we are focusing upon this, we are highlighting it, we are ventilating it, and we are calling into question the practices that have been going on too long.

Yes, changes have been made and more progress is needed, but unless we keep the pressure on, we are not going to see the kinds of fundamental changes that are necessary. So I commend you and Senator Grassley and the other witnesses that will be coming before the Committee.

Chairman GLENN. Thank you, Senator Cohen, very much. You have been one on the Committee here who has had an interest in this for a long time. I think you have attended every hearing on this subject. We all have other commitments, I know, and I am sure you will get back if you possibly can for the rest of the hearing.

Senator Grassley, although you are not a member of the Committee, you have been working in this area for a long time. You have had legislation in this area and you are certainly to be commended for your interest here. We are not just talking peanuts, a few dollars here and there. We are talking about many, many tens of billions of dollars, and you get into these reports, "x" numbers of billions in unmatched disbursements and all sorts of things going on which are just ridiculous. So we look forward to your testimony.

TESTIMONY OF THE HON. CHARLES E. GRASSLEY, U.S. SENATOR FROM THE STATE OF IOWA

Senator GRASSLEY. Mr. Chairman, thank you very much for this opportunity to testify. Most importantly, your hearings and your work not only hopefully will lead to the saving of taxpayer dollars, but also decrease the amount of cynicism that the public has in Government generally because they know about the waste that goes on, and the latter might be as important as the former in the good that comes out of your work.

Mr. Chairman, the case of James Edward McGill shows how it is easy to steal tax money when there are no effective internal financial controls. There is a need for more accountability. Mr. Bowsher and Mr. Vander Schaaf have repeatedly warned that DOD

accounts are vulnerable to theft and to abuse, but the warnings have had no effect, it seems like.

These are the facts in the McGill case, as revealed by the U.S. Attorney in Norfolk, Mr. James Metcalfe. Mr. McGill's scheme was really very simple. First, he invented a corporation to provide fictitious supplies and services to the Military Sealift Command. He rented a mailbox in the company's name. He attained Government ordering and paying documents Form DD 1155 and NAVCOMPT 2276. He purchased printed company invoices, along with several rubber stamps, to record "materials received and accepted," and to date the accounts and the documents. With these very basic devices, and no more, he began generating phony claims using bogus contract numbers. Next, he forged the signatures of non-existent certifying officials and authorizing agents.

McGill then mailed these fraudulent documents to the local Navy and Defense Finance and Accounting, or DFAS, offices in Norfolk for payment. McGill just tapped the DOD money pipeline. Once McGill's invoices hit the payment center, they were really on automatic pilot and the checks just started rolling in. There were no questions asked. Between January of 1989 and December of 1993, McGill filed over 100 false claims. He was actually paid \$3,025,677.99. The checks ranged in size from \$7,419 up to \$53,052.

In sum, Mr. Chairman, Mr. McGill had nothing more than a mailbox, a couple of rubber stamps, and blank Government forms, and he was in business to cheat the taxpayers. He delivered no goods and he did no work, but he had no trouble doing business with the U.S. Navy. So how did McGill ever get caught?

An alert accountant at the Military Sealift Command headquarters in Bayonne, New Jersey, noticed that charges against the general ledger account were for a vessel that had been placed in moth balls. A quick check blew the cover on McGill's whole operation. The check found the ship referenced in McGill's fabricated accounts, the USNS Neosho, had been decommissioned. Stock and part numbers and prices used did not match the items listed. Items that were listed were uncommon and suspect. Amounts exceeded ceiling allowed by the forms used. Cost code numbers were incorrect, and a search of Navy files revealed that the authorizing officials' signatures forged by McGill were completely fictitious.

A quick check like this in 1989 would have shut down McGill's operation before it got started, but that, of course, didn't happen. Thirty-two of McGill's claims against the Neosho slipped through the net before he got nailed. Mr. McGill has pleaded guilty and will be sentenced May 12. If Mr. McGill had not been so careless as to use the name of a decommissioned ship, he would still probably be in business. This is what makes the McGill case so scary.

It is almost identical to the Lugas case, and I know, Mr. Chairman, that you are very familiar with that because you have exposed that. Mr. Lugas stole at least \$2,094,318 from the stock fund and commissary accounts at Reese Air Force Base in Texas. The commissary and stock fund accounts belong to DBOF, the Defense Business Operations Fund.

The money stolen by Mr. McGill was stolen from the Military Sealift Command, which also belongs to DBOF. Both were caught

by chance and not as a result of effective internal controls. Mr. Lugas was caught because of his lavish lifestyle. His neighbors thought that he was a drug dealer and they reported him to DEA. But there are some differences. The Lugas case was an inside job.

As an accountant, Lugas was able to monkey with the books to force them into balance, and he relied on the sloppy and hit-and-miss audit work to escape detection. Mr. McGill, by comparison, was an outsider. Yet, he was able to easily manipulate the procurement system and never worried about forcing the books into balance. The books don't balance anymore and nobody seems to care. The Lugas case and the McGill case go right to the heart of the problem before the Committee today.

What I have here, Mr. Chairman, in all of these documents is a stack of recent audit reports issued by Mr. Vander Schaaf's office and by Mr. Bowsher's office. The stuff in these reports ought to blow your mind, if you study it and if we think about it, because there is really a common thread running through them—unmatched disbursements totaling billions of dollars. Unmatched disbursements on such a scale may be one reason why people like Lugas and McGill can rip into the National money sack and never get caught.

Unmatched disbursements are payments or checks that cannot be linked to supporting documentation, like contracts or obligations. Payments to Lugas and McGill, by their very nature, had to be unmatched disbursements. They could never be linked to contracts and accounts. Why? Because there were none.

The General Accounting Office says that DOD has at least \$41 billion of unmatched disbursements, but no one knows the exact amount for sure. That is just a rough guess. DBOF alone has more than \$4.7 billion in unmatched disbursements. The DFAS finance center at Cleveland had over \$10 billion worth. Many have been unmatched for years. Both Lugas and McGill hit on DBOF accounts. McGill's checks were processed at that Cleveland center.

MR. BOWSHER AND MR. VANDER SCHAAF will confirm one simple fact. If a check cannot be matched with an obligation, we don't have any way of knowing what happened to the money. DOD could be sitting on billions of dollars in fraudulent payments. We will not know how many are fraudulent until all payments are properly matched.

Mr. Chairman, this is obviously a dangerous mess. Quite simply, I think it stinks. But in a more sophisticated way, former Secretary of Defense Aspin characterized DOD financial management as, "a lot of horror stories." Secretary Perry agrees. Comptroller Hamre agrees. Mr. Chairman, it seems like we have a consensus.

Mr. Bowsher keeps saying, "The breakdown of financial controls and discipline in accounting for the taxpayer's dollars is inexcusable and should not be tolerated." Mr. Chairman, we need to pay attention to Mr. Bowsher.

Responsible officials must now be held accountable and disciplined for what has happened if we are going to make any changes. Mr. Hamre deserves a lot of credit for what he is trying to do. He has developed a plan to fix the problem. He has discussed it with a lot of us on the Hill, including myself, and I think he is on the right track. But Mr. Hamre's plan is lacking in one area,

accountability. Mismanagement and wrongdoing must have consequences. It seems to me like heads must roll. Without accountability, Mr. Hamre's fix won't work.

Sadly, Mr. Chairman, accountability is not on the way. Rather, rewards for business as usual are on the way. I have here with me a memo that is dated March 9, 1994. It is signed by Mr. D.O. Cooke, Director of Administration and Management. It announces the recipients of the 1993 Presidential Rank Awards. Four recipients of the award and \$10,000 cash bonuses are senior DFAS officials—John P. Springett, DFAS Director; Lorraine F. Lechner, DFAS Deputy Director; John S. Nabil, Director of the Denver center, and his predecessor, Clyde E. Jeffcoat, Director of the Denver center in 1991–1992.

DFAS—and, remember, that is the Defense Finance and Accounting Service—is directly responsible for many of the problems that are the focus of today's hearing. These four officials are in charge; they run the show, they are accountable. Mr. Jeffcoat ran the Denver center when \$649.1 million in M account money was used to balance the books. The cash bonuses are rewards that send the wrong signal to the rest of the financial management community. We say that fixing the problem is a top priority, but then what do we do? We reward those who are responsible for the problem.

Mr. Chairman, I would like to leave the Committee with just two recommendations, very short. First, responsible officials should be identified and removed from office. Second, Presidential awards should be reviewed and should be reconsidered. Mr. Chairman, we need to help Mr. Hamre clean house. Without accountability, nothing Congress does will count much.

I thank you very much.

Chairman GLENN. Thank you very much, Senator Grassley. I appreciate your remarks very much and I look forward to working with you in these areas as we move on into our legislative session not only out of this Committee, but on Defense authorization, also, this year.

Senator GRASSLEY. Thank you very much.

Chairman GLENN. Thank you very much.

PREPARED STATEMENT OF SENATOR GRASSLEY

Mr. Chairman, and Senator Roth, thank you for giving me the opportunity to testify on financial management at the Department of Defense (DOD).

Mr. Chairman, I would like to talk about the case of James Edward McGill that shows how easy it is to steal tax money when there are no effective internal financial controls.

And I would like to talk about the need for accountability.

Mr. Chairman, Mr. Bowsher and Mr. Vander Schaaf have repeatedly warned: DOD accounts are vulnerable to theft and abuse.

But the warnings had no effect.

These are the facts in the McGill case as revealed by the U.S. Attorney in Norfolk, VA., Mr. James A. Metcalfe.

Mr. McGill's scheme was very simple.

First, he invented a corporation to provide fictitious supplies and services to U.S. Naval Ships of the Military Sealift Command.

He rented a mail box in the company's name.

He obtained government ordering and payment documents—forms DD 1155 and NAVCOMPT 2276.

He purchased printed company invoices along with several rubber stamps to record "material received and accepted" and to date documents.

With these very basic devices in hand, he began generating phony claims, using bogus contract numbers.

Next, he forged the signatures of nonexistent certifying officials and authorizing agents.

McGill then mailed these fraudulent documents to the local Navy and Defense Finance and Accounting or DFAS office in Norfolk for payment.

McGill just tapped the DOD money pipe.

Once McGill's invoices hit the payment center, they were on "automatic pilot."

And the checks just started rolling in—no questions asked. Between January 1989 and December 1993, McGill filed over 100 false claims. He was actually paid \$3,025,670.99. The checks ranged in size from \$7,418 up to \$53,052.

In sum, Mr. Chairman, Mr. McGill had a mail box, a couple of rubber stamps, and blank government forms. And that's it.

He delivered no goods and did no work.

But he had no trouble doing business with the U.S. Navy.

So how did McGill get caught?

An alert accountant at the Military Sealift Command headquarters in Bayonne, New Jersey, noticed that charges against a general ledger account number were for a vessel that had been placed in mothballs.

A quick check blew the cover on McGill's whole operation. It found:

—the ship referenced in McGill's fabricated documents—the USNS Neosho—had been decommissioned;

—Stock and part numbers and prices used did not match the items listed;

—Items listed were uncommon and suspect;

—Amounts exceeded ceilings allowed on the forms used;

—Cost code numbers were incorrect;

—And search of Navy files revealed that the authorizing officials' signatures forged by McGill were completely fictitious.

A quick check like this in 1989 would have shut down McGill's operation before it got started. But that didn't happen.

Thirty-two of McGill's claims for work on the Neosho slipped through the net before he got nailed.

Mr. McGill has pleaded guilty and will be sentenced on May 12th.

If Mr. McGill had not been so careless as to use the name of a decommissioned ship, he would still be in business.

This is what makes the McGill case so scary.

It is almost identical to the Lugas case. Mr. Chairman, I know you are familiar with the Lugas case.

Mr. Lugas stole least \$2,094,318.50 from the stock fund and commissary accounts at Reese Air Force Base, Texas.

The commissary and stock fund accounts belong to DBOF—the Defense Business Operations Fund.

The money stolen by Mr. McGill was stolen from the Military Sealift Command, which also belongs to DBOF.

Both were caught by chance and not as a result of effective internal controls.

Mr. Lugas was caught because of his lavish lifestyle. His neighbors thought he was a drug dealer and reported him to the DEA.

But there are some differences.

The Lugas case was an inside job.

Lugas, as an accountant, was able to monkey with the books to force them into balance. And he relied on sloppy, hit-or-miss audit work to escape detection.

Mr. McGill, by comparison, was an outsider. Yet he was able to easily manipulate the procurement system and never worried about forcing the books into balance.

The books don't balance anymore and nobody cares.

The Lugas case and the McGill case go right to the heart of the problem before the Committee today.

What I have here, Mr. Chairman, is a stack of recent audit reports issued by Mr. Vander Schaaf's office and Mr. Bowsher's office.

The stuff in these reports will blow your mind—if you study it and think about it.

There is a common thread running through them—unmatched disbursements totaling billions of dollars.

Unmatched disbursements on such a scale may be one reason why people like Lugas and McGill can rip into the national money sack and not get caught.

Unmatched disbursements are payments or checks that cannot be linked to supporting documentation, like contracts and obligations.

Payments to Lugas and McGill, by their very nature, had to be unmatched disbursements. They could never be linked to contracts and accounts, because there were none.

The GAO says that DOD has at least \$41 billion of unmatched disbursements. But no one knows the exact amount for sure. It's just a guess.

DBOF alone has more than \$4.7 billion in unmatched disbursements.

The DFAS finance center at Cleveland had over \$10 billion worth. Many have been unmatched for years.

Both Lugas and McGill hit on DBOF accounts. McGill's checks were processed by the Cleveland center.

Mr. Bowsher and Mr. Vander Schaaf will confirm one simple fact:

If a check cannot be matched with an obligation, we don't have any way of knowing what happened to the money.

DOD could be sitting on billions of dollars in fraudulent payments. We will not know how many are fraudulent until all payments are properly matched.

Mr. Chairman, this is a dangerous mess. It stinks.

Former Secretary of Defense Aspin has characterized DOD financial management as "a lot of horror stories." Secretary Perry agrees. Comptroller Hamre agrees.

Mr. Chairman, we have a consensus.

Mr. Bowsher keeps saying: "the breakdown of financial controls and discipline in accounting for taxpayer's dollars is inexcusable and should not be tolerated."

Mr. Chairman, we need to pay attention to Mr. Bowsher.

Responsible officials must now be held accountable and disciplined for what has happened.

Now Mr. Hamre deserves a lot of credit for what he is trying to do.

He has developed a plan to fix the problem. He has discussed it with me, and I think he is on the right track. But Mr. Hamre's plan is lacking in one area—accountability. Mismanagement and wrongdoing must have consequences.

Without accountability, Mr. Hamre's fix won't work.

Sadly, Mr. Chairman, accountability is not on the way. Rather, rewards for business as usual are on the way.

I have here a DOD memo dated March 9, 1994. It is signed by "Doc" Cooke, Director of Administration and Management. It announces the recipients of the 1993 Presidential Rank Awards.

Four recipients of the award and \$10,000 cash bonuses are senior DFAS officials:

—John P. Springett, DFAS Director

—Lorraine F. Lechner, DFAS Deputy Director

—John s. Nabil, Director, Denver Center

—Clyde E. Jeffcoat, Director, Denver Center (1991-92)

DFAS—the Defense Finance and Accounting Service—is directly responsible for many of the problems that are the focus of today's hearing. These 4 officials are in charge. They run the show. They are accountable.

Mr. Jeffcoat ran the Denver center when \$649.1 million in M account money was used to balance the books.

These rewards send the wrong signal to the rest of the financial management community. We say that fixing the problem is a top priority but then we reward those who are responsible for it.

Mr. Chairman, I would like to leave the Committee with two recommendations: First, responsible officials should be identified and removed from office;

Second, Presidential awards should be reviewed and reconsidered;

Mr. Chairman, we need to help Mr. Hamre clean house. Without accountability, nothing Congress does will count for much.

Chairman GLENN. Our next witness will be Charles Bowsher, Comptroller General of the United States. Mr. Bowsher, welcome to our hearing this morning. This is a subject on which we have met a number of times in the past and you have done—I don't even have any idea how many reports you and your associates have completed on this particular subject through the years, but it has been a lot them. I think we are moving into a new time, a new emphasis on this, and I hope we can put as much attention on how we spend the dollars as where they come from and what taxes we have to charge and what the appropriations are because, in effect, when we waste money we are just requiring it in the other area for the same amount of defense, and that is wrong.

We look forward to your testimony this morning.

TESTIMONY OF CHARLES A. BOWSHER, COMPTROLLER GENERAL, U.S. GENERAL ACCOUNTING OFFICE; ACCOMPANIED BY DAVID COOPER, DAVID CONNOR, AND DAVID NELLEMANN

Mr. BOWSHER. Thank you very much, Mr. Chairman. It is a pleasure to be here today. As you have pointed out, we have been here many times to discuss the need for the Department of Defense to improve financial management over its vast resources and operations.

Without fundamental change and sharply increased attention to basic management, DOD cannot successfully move toward a smaller and more efficient force structure. Moreover, it will remain unable to ensure accountability for over a \$300 billion annual budget and close to \$1 trillion in assets.

Financial management problems have been pervasive at the Department of Defense for years. A major overhaul of its financial systems and operations is long overdue. Frankly, I often have been discouraged by DOD's inability to fully recognize the scope and the depth of its financial management deficiencies. Without such recognition, concerted efforts needed to fix those problems have not been forthcoming.

I am, though, as you have mentioned in your opening statement, Mr. Chairman, encouraged by the recent frank admissions by the Secretary of Defense and the Department of Defense's new Comptroller on the financial management problems that DOD faces. Secretary Perry said it well in recent testimony discussing DOD's fiscal year 1995 budget request, "We need to reform our financial management. It is a mess and it is costing us money we desperately need." Such statements are an encouraging sign that the new DOD leadership is taking its financial management responsibilities seriously, a necessary and critical first step needed to bring about desperately needed fundamental changes.

Much of the credit for this encouraging change, I think, must go to the Chief Financial Officers Act which this Committee, under your chairmanship, was instrumental in enacting. Annual audits conducted as a result of this legislation have served as an important catalyst for identifying and focusing management attention on the extent and the seriousness of the financial problems facing the Department.

I applaud your Committee for its recent efforts to pass a bill amending the CFO Act to extend the annual audit requirements to all major Federal agencies, including DOD and the military services. When enacted, these amendments will provide an important permanent tool for assisting all Federal managers in their continuing efforts to improve financial management.

The problems you asked us to highlight today vividly illustrate the scope and the depth of the financial management weaknesses that waste DOD resource and hamper its operations. First, with respect to contractor overpayments, we testified last July that contractors returned \$751 million in contract overpayments to DOD during the first 6 months of fiscal year 1993. Our follow-up report on those payments which is being released today shows that most

were voluntary returns detected by contractors rather than by the DOD controls. When the Government must rely on contractors rather than its own controls to detect and recover overpayments, the risk of loss is unacceptably high.

Mr. Chairman, when we were going through our work, one of the things we saw, too, is, I think, fairly typical. In other words, here comes an invoice in here for \$5 million, but it shows progress payments of \$3.9 million. Obviously, when they processed it, they overrode the system and they sent out the full \$5 million. So here, then, a check 2 months later comes back from the contractor for the \$3.9 million in progress payments that had already been made. So, that is the kind of example that we are looking at here when we are looking at these returned checks from the contractors, and it is big money. Lots of times, a lot of time goes by even before the money comes back to the Government.

Now, second, of course, is the weak disbursing controls that have led to fraudulent payments, and I think Senator Grassley described quite well here the recent case of this former DOD supply officer who set up a fictitious company and received an estimated \$3 million during a 4-year period for over 100 bogus invoices.

Third, as you requested, we also have been monitoring efforts to address an estimated \$8 million in improper Army payroll payments. This included payments to 6 ghost soldiers and 76 deserters. To date, four individuals have been incarcerated and a number of other fraud cases remain under investigation. An attachment to the statement I am submitting for the record provides disturbing examples of how many improper payments were made. If people that have my statement turn to page 34, they will see that the first example was the one I think that you mentioned, Mr. Chairman, in your example where they set up the ghost soldier. They actually even promoted him; they moved him about. He got promoted, I think, six ranks to sergeant first class.

If you jump to page 39, you will see that there are actually big amounts here because then we have got an example of a reserve major who entered service for 2 days during July 1991, and then after separation the officer was not removed from the active payroll and the separated officer continued to receive pay throughout July 1993 when the overpayment was surfaced by our audit. During part of that period, he also collected reserve pay. Now, his total amount that he got was \$149,000 there, so we are talking about big money.

In Example 9 on the next page, another reserve major got separated but continued to receive money, and his amounted to \$51,000. In Example 10, you can see that there was an error in a separation check that went out for \$836,000 instead of \$183. That person invested money and that case is now pending. So these are some of the illustrations, unfortunately, that we have come up with, and the Army is following up and trying to investigate all of these cases.

Next, we also have seen continuing problems in DOD's process for matching its disbursements against related obligations. That, of course, is another issue that Senator Grassley pointed out. This is a very serious problem. Essentially, billions of dollars in DOD pay-

ments have been made for which the Department has not been able to readily determine exactly what it bought.

As of December 1994, DOD reported that it had reduced its unmatched disbursements from \$19 billion in March 1993 to \$12.6, still a substantial amount. However, it is likely that this amount does not include all the problem disbursements because they have been netting some of these efforts. Consequently, the true extent of the Department's disbursement accounting problems is not yet known.

Chairman GLENN. Could I ask a question right there?

Mr. BOWSHER. Sure.

Chairman GLENN. On unmatched disbursements, have we tried to see whether there was justification for the payments being made and could not find matching, or is this—in other words, are payments made and then a lot of times the paperwork for it does come along later, or are these amounts of \$19 billion ones where we have looked at the account and can't find justification for it after we have looked for it? Which way is it?

Mr. BOWSHER. Let me ask Dave Cooper—

Chairman GLENN. Incidentally, just for the record, also, would you introduce your colleagues here today? I don't believe we got their names on the record here.

Mr. BOWSHER. OK; Dave Cooper on my right, Dave Connor on my left, and Dave Nellemann on my left.

Chairman GLENN. We welcome all of you. [Laughter.]

Mr. BOWSHER. Everybody is a Dave, I see. You can't get on this team unless you are a Dave. [Laughter.]

Mr. COOPER. Mr. Chairman, basically what we are finding when they are writing the checks is they go to the records and either the records are inaccurate or they are missing records for, like Mr. Bowsher showed, the progress payments. What happens is there is an emphasis at the DFAS to get the checks written and get them to the contractors, and the emphasis is not on accuracy as much as it is just getting the checks out the door.

They are having a very, very difficult time because once they write these checks they have to go back and try to find the documentation. It may be there, it may not be there, and it is just a horrendous problem trying to reconcile all the records and ensure accuracy.

Chairman GLENN. OK. Well, I am not sure I understand yet, though. Are these ones where we really have checked and can't find substantiation?

Mr. COOPER. In some cases, they are still searching the records and trying to reconcile the number of contracts. As our report points out, there were like 6,600 contracts that needed to be reconciled to get at the very point that you are talking about, and that is whether those payments are accurate payments or whether there is an action that is needed to recover overpayments.

We just learned last week that that number may be as much as 26,000 contracts that need to be reconciled. So there is a tremendous job ahead of DOD to try to find out whether it is paying accurate amounts to its contractors.

Mr. BOWSHER. Dave, do you want to answer?

Chairman GLENN. Go ahead, Dave.

Mr. CONNOR. Of the \$41 billion, approximately half of that was the true unmatched. We couldn't match up the disbursements and obligations. The other portion would have been in process where we were trying to find the obligation to make the match.

Chairman GLENN. You would find some of those, I presume.

Mr. CONNOR. That process is ongoing and there is a normal time lapse to get the disbursement to the obligation.

Chairman GLENN. OK. What I am trying to find, though, is out of that \$19 billion in unmatched disbursements, we just have no way of knowing one way or the other whether any of that amount was justified, then, is that correct?

Mr. CONNOR. It takes a great deal of research to make that determination. DOD does have a task force researching it and working that problem. The task force reports that it has reduced that 19 to 12. We haven't verified that. We are doing work for this Committee on that. We will follow up with you.

Chairman GLENN. Thank you.

Mr. BOWSHER. All right. The fifth issue is that I testified before your Committee last July when DOD could not properly implement Public Law 101-510, commonly referred to as the M account law. We pointed out that DOD did not have adequate controls over the M accounts and could not adequately document millions of dollars in budget authority restored to correct what it characterized as over 30 years of accounting errors.

Unfortunately, DOD's problems with accurately accounting for its M accounts continues. For example, we recently notified the Secretary of Defense that DOD had five M account appropriations which, according to DOD financial reports, may have been overexpended by almost \$153 million at the end of fiscal year 1993.

Finally, we continue to support the concepts underlying DOD's initiatives to reform its administrative operations and financial systems. However, these initiatives have had only limited success to date in achieving their fundamental management reform objectives. With respect to the \$77 billion Defense Business Operations Fund, often referred to as DBOF, critical concerns over basic issues concerning the fund's policies and procedures, the financial reports and the systems may not be completed until fiscal year 1995. DOD's efforts to improve its financial systems under DOD's Corporate Information Management initiative also has had some disappointing results.

While DOD has moved on selecting and modifying interim financial systems and developing target system requirements, it does not have a comprehensive strategic information systems plan or sufficient management attention to effectively monitor and guide the completion of its ambitious goals.

Overall, unfortunately, I am not reporting much today in the way of complete or concrete improvements to you. Pervasive and fundamental financial management problems persist. Nonetheless, there is some reason here for some cautious optimism. I believe with the new DOD leadership in place, the Department is now positioned perhaps for the first time to make the fundamental changes that will be necessary to bring about a better managed and more fully accountable Department of Defense.

It is now critical that DOD take the next step in transforming its candid acknowledgement of problems into comprehensive, realistic action to effectively resolve these problems. In this regard, the annual financial audits conducted as a result of the CFO Act will provide an important tool for DOD leadership to monitor the efforts to resolve the weaknesses I have discussed today. However, meaningful, lasting results will not occur unless DOD puts forth concerted top management attention over a sustained period. Mr. Chairman, you pointed that out that what we need here is sustained leadership over an extended period if we are really going to accomplish this.

That concludes my statement, Mr. Chairman, and we would be pleased to answer any questions.

Chairman GLENN. Thank you very much, Mr. Bowsher, and your entire statement will be included in the record. How do we know that a lot of this stuff here that you have turned up is not going on multiplied many times over and we just haven't caught it yet? Is there any guarantee that that is not still going on?

Mr. BOWSHER. Oh, no. I think it is possible that a lot more is going on at this point in time. Without your modern systems, without proper controls, without the discipline that you need in this kind of operation, we are only finding, I am sure, a certain percent of the problems as we do these audits. Therefore, I think that potentially many more problems are out there and are going undetected.

Chairman GLENN. In almost all of these cases there was overpayment or wrong payment to contractors, the contractor was the one who notified the Government of the overpayment or the erroneous payment, whatever it was. What progress can you note that DFAS is making in controlling that since our hearing last July? Is anything being done?

Mr. BOWSHER. Well, they are working on some efforts here, but the statistics indicate that during the last 6 months of 1993, they received about the same amount as they had received in the first 6 months, namely about \$1.5 billion here, and so far in the first quarter of fiscal 1994 they have received \$225 million coming back from the contractors.

So I think that we have to recognize at this moment in time the problem still persists and many of these errors are being found one more time by the contractors, not by the Department's people or their systems.

Chairman GLENN. It is my understanding that in some of these cases where there was an overpayment the Government just tells them to hold on to the money instead of returning it. What about this, or why would that be done?

Mr. BOWSHER. Well, they do that because they want to work with the paperwork and everything like that, but that, of course, has some bad disadvantages because, one, the Government is not getting the money back as fast as it should. Two, we have run into instances where lots of times—not lots of times, but sometimes the companies have sent checks back to the Government and then they haven't cleared. We have one document here that indicates that contractors would like to know what has happened, and now the

Government is trying to run down some of these checks that they finally got back but didn't process.

So I think one of the things they have to do is start to get a system where they expeditiously try to get this money back and get it deposited, and let us try to get on top of that part of the problem, at least.

Chairman GLENN. Well, what this does, in effect, if I understand it right, is this would, in effect, give that particular company or contractor a loan, no interest, no nothing; just keep the money and use it for your own investment for a while if you want to. Is that correct?

Mr. BOWSHER. That is right. Many of the overpayments we examined were outstanding for more than 90 days. So, obviously, the Government incurred millions of dollars of interest costs on these overpayments. We also found a situation where one of the companies was actually holding on to these overpayments, setting up an account, and then working off that account as they saw their other work being handled. Of course, that is not proper at all.

Chairman GLENN. Contractors working for DFAS, as I understand it, have reconciled some 4,300 contracts, but there are some 6,600 so-called problem contracts that still need to be looked at. Many of those won't be reconciled for years, and many contracts may never get reconciled because the documentation is bad or doesn't exist. Has DFAS moved to correct these things so that we just don't pay it unless there is documentation?

Mr. BOWSHER. Well, I think this problem might even be bigger than those numbers which we gave you, Mr. Chairman, indicate. I think that is the one, Dave, where now the Defense Department thinks there might be larger numbers of contracts that have not been reconciled, is that right?

Mr. COOPER. Yes. The latest estimate we got just last week was that that number of 6,600 has grown to almost 26,000 contracts that need to be reconciled.

Mr. BOWSHER. This is a huge problem.

Chairman GLENN. Do you have any idea what dollar value there is on those 26,000 contracts?

Mr. COOPER. No, we don't have any estimate on that. What we are finding as we are continuing to do work for your Committee is that, as Mr. Bowsher pointed out, some contractors are not returning the monies to the DFAS center in Columbus. We have visited three contractors since our report was issued, and at one of those locations we found \$20 million sitting there that hasn't been returned.

Chairman GLENN. Do you have any examples of contractors that have either returned money or have refused, or are being given favored treatment, in effect, by not requiring immediate repayment?

Mr. COOPER. Not favored treatment. Because of all the administrative effort that is required to return checks and to sort things out, really DFAS is trying to work with those contractors to say, just hold that money and work that overpayment off against future work. But it gets back to the problem that you identified on this interest-free loan issue, the Treasury is paying out a lot of money and the money is just sitting there.

Chairman GLENN. Yes, but progress payments weren't even taken into account before. That was one of the reasons that some of these overpayments were made.

Mr. COOPER. That is correct.

Chairman GLENN. There is no reason to think that we are going to be able to keep track of the amount we have given them now in advance.

Mr. COOPER. No. We think that holding that money and not returning it could really exacerbate the problem and cause more confusion and cause more problems when the reconciliation occurs.

Chairman GLENN. It is my understanding that you have found some \$175 million in the 43 accounts that have been reconciled so far. Is that correct?

Mr. COOPER. That is correct, yes.

Chairman GLENN. One thing that came up, too, was another indicator of the contract pay problem, as I understand it, is that some \$2.5 million of Treasury checks are returned to DFAS every month because the post office can't deliver them. What is the story on that?

Mr. COOPER. What we are finding there on those checks is that you have either got the wrong address on the check; or it is the wrong amount; or, the contractors moved locations. There is a real basic problem with just having good, accurate information on where to send the check and how much the check ought to be for.

Chairman GLENN. The \$175 million outstanding on debts owed for reconciled contracts I mentioned a moment ago—as I understand it, only some \$73 million of that has been collected so far. How come?

Mr. COOPER. Mr. Chairman, I think the situation there is that some of that is still in the resolution process where DFAS is working with the contractors to ensure that the amounts are the proper amounts. As our report points out, the concern that we have about the timeliness of all of this action is that some of these contractors have gone out of business or are bankrupt or moved or don't have the cash to pay the Government the amounts that it is due back. We pointed out that \$17 million of that amount may never be collected because of those reasons.

Chairman GLENN. I have been told that in your talking with some of the Defense Department officials, some of them tended to downplay this problem and take the position that overpayments aren't that serious because we get the money back or the contractor eventually earns the overpayments by additional work, which seems to me like a rather weak reed to stand on.

Mr. BOWSHER. Yes. I think that is a terrible attitude myself. In other words, what you have got here is old systems in Columbus that they have got to develop, I think, either modern systems or do something to get it modernized, and even look at their overall business practices, not just look at the systems, but how they are running this whole practice here.

Then you have got different systems in the accounting centers out in the different services which this paperwork feeds out into. So what you really need here is a major, major systems effort in business practices review to modernize and take advantage of mod-

ern computers and communications, but it is really a big job that the Department of Defense is facing.

Chairman GLENN. We have had Army payroll fraud, \$7.8 million, which is about 30 percent higher than originally disclosed; six ghost soldiers, 76 deserters. Yet, your testimony indicates that the continued investigation of Army payroll fraud may not be completed for 3 years. Is that right, and why is it taking so long? If it takes that long to just investigate the cases we have now, it makes one wonder how many more cases are there out there that we just haven't even come across yet.

Mr. BOWSHER. It takes a long time because each of these cases, once it looks like there might be some criminal wrongdoing, it is like handling a criminal case. Also, trying to pull all the information together takes some time. I think the big problem really is—what they should be getting on to is to make sure that their controls are in place so that we don't have future situations here.

This is an area that I think the military could correct fairly easily and quickly because what you are talking about here is basic controls and basic discipline in checking out how well the controls are working. The three basic controls here are that you have got undelivered leave and earning records that were not being returned to DFAS. Thus, DFAS was unaware that the soldier was missing and so the pay continued. Now, that can be corrected.

Another very simple thing here is that Army unit commanders are not properly utilizing the unit commanders' finance report that would have identified most of these ghost soldiers assigned to their units. So this is a case of the unit commanders just checking out to make sure that who is on their list is actually in their unit, and the financial clerks that are putting these ghost soldiers on these payrolls should be able to be checked, too. In other words, there should be able to be controls set up to achieve that. So I think this is an area that the military should really work hard on in the immediate future and get on top of.

Chairman GLENN. What we have been talking about here is a few million here and a few million there, and pretty soon it all adds up, of course. But I don't understand how the Defense Department could have paid \$41 billion worth of bills that had never been matched to obligations. You couldn't do that in a company; you shouldn't be able to do it in the U.S. Government.

They are supposed to have payments match invoices before they are made by all the rules and regulations under which we operate. How do you get \$41 billion paid out not matched to obligations?

Mr. BOWSHER. Well, they override the system. In other words, there is such an emphasis on getting the payments out there that if they can't match, they just pay and then they say we will match later.

Chairman GLENN. But according to what you said a little while ago here, or Mr. Cooper said a little while ago here, a very high percentage of these things never get matched.

Mr. BOWSHER. That is the unfortunate thing.

Chairman GLENN. So that there is no record of what portion—

Mr. BOWSHER. In other words, chasing that kind of paperwork is not easy, and we learned, in fact, in the private sector many years ago that you have to set your systems up so that you don't rely

upon that kind of follow-up matching. You have got to have the discipline of a system where you can match the information and do it accurately the first time.

Chairman GLENN. How do we hold people accountable? Somebody has got to be accountable on this. This is taxpayer money we are talking about. We are talking about \$41 billion. We fuss and fume over whether it is going to be a \$260 billion Defense budget, or 258, 240, whatever it is going to be in that realm right now. Yet, we have \$41 billion and we don't even know that it was paid correctly—\$41 billion.

Mr. BOWSHER. Well, I think the accountability should start right at the top there and that this Committee ought to hold the senior financial people at the Department of Defense responsible for a plan to get on top of these problems here in these big systems areas because that is what it is going to take to get this working.

I know that they are developing their plans now, but I think just as you said, Mr. Chairman, earlier in the hearing here, we have got to have a sustained effort over a sustained period of success, and I think that an annual hearing when they come forward to explain how well they are doing before this Committee would be a major benefit, and hopefully that would start to get some of this problem handled, you might say.

Chairman GLENN. Can we ever have accountability as long as the civil service rules are the way they are?

Mr. BOWSHER. I think you can. I think the civil service rules sometimes get in the way of moving people out that are not performing. I will be the first to admit that, but at the same time I think that these problems here could be dealt with with the civil service rules that we have.

Chairman GLENN. There has to be some way of getting accountability. I know that. My time is up.

Senator Dorgan?

Senator DORGAN. Mr. Chairman, thank you very much. I would like to follow up on a number of questions the Chairman has asked. It almost seems to me like this is sort of no-fault Defense management. I have been trying to find accountability for certain decisions that have been made that have wasted a lot of money in several different areas, and it is almost impossible.

The Chairman is asking the question, well, who is responsible if you have billions of dollars paid out for invoices that were sent to the Defense Department but for which there was no work done or no products sent? Who would be responsible for making payments like that or not checking on it?

Let me go back to the McGill case and ask you a couple of questions. This is a person that has been through the criminal justice system. I think in previous testimony it was said that this is a person who will be sentenced in May. In that case, just as an example, this person set up a mailbox, printed some forms, and starting doing business with the Government, but his business was not to ship the Government anything. His business was simply to ship them an invoice to get money in return, and for about a 4-year period he would send invoices and get payments back for which there was no work or no product exchanged.

Now, you indicated that the Defense Department people said, well, because of the Prompt Payment Act, et cetera, we have got to ship a payment out to this person, and then they checked a little later to try to match up the reimbursement they made for the performance of some contractor. In the case of McGill, obviously if you do that for several years, there is no matching going on, is that correct?

Mr. BOWSHER. That is correct, I would guess, in that case.

Senator DORGAN. But are there regulations in place that say we will make the payment now and then we will go back and match it?

Mr. BOWSHER. No. Let me have Dave Connor respond, but I think it is a more a case that the system is in place as to what to do, but then when they get behind they say, well, let us override the system; let us go ahead and make the payments.

Mr. CONNOR. Yes. The Sealift Command was a little bit unique in that they were not following a policy of matching detailed obligations with detailed expenditures.

Senator DORGAN. All right. Do we have accountability for that? Who in the Sealift Command says, look we will no longer match; if somebody sends us a bill, let us send them a payment; let us not take a look to see whether they did something for us; let us decide to disconnect this requirement, for whatever reason—we don't have manpower, or whatever? I, in Sealift Command, have decided we won't match anymore. If they send us a bill, we will send them some money. Do we know who makes these decisions? It gets back to the Chairman's question of accountability. Who is accountable for this sort of thing?

Mr. CONNOR. That decision would have been made some time ago because it wasn't the ongoing policy. They have recently decided to revamp their systems to accomplish that detailed matching, but when it was seized, we don't know.

Senator DORGAN. I understand that it may have been some while ago, but a previous witness was saying we are giving awards to people in Government who were in charge of systems that he charged were failing. Are we establishing accountability? Do we know who did that some while ago?

Mr. CONNOR. We don't have that information.

Senator DORGAN. I will just tell you as an aside, Mr. Bowsher, you know that I have been looking at this \$27 million building that they had a ribbon-cutting for 2 weeks after it had been determined it was not going to be used, and I have been trying to find out who decided to build a \$27 million building that wasn't necessary. It is clear now it wasn't necessary, but even your organization is a little bit ginger in trying to tell me who was responsible.

Nobody really ever wants to get into the business of saying these three people did it; they are responsible for wasting \$28 million. I think the Chairman is asking that same question with respect to \$41 billion or, in DBOF, \$4.7 billion. Who really is responsible for allowing things to happen that first-year accounting students would understand are fundamentally wrong?

Mr. BOWSHER. Well, it is basically the people that are in charge of these accounting and disbursement centers, but what happened is, over years, people were accepting of this. In other words, they

were accepting this. I think we have often talked here that you have a lot of accountability in the military when you are out with the forces in a military sense, but then over the years when you are in the shore establishment and you are having weapons systems that have cost overruns and lots of problems like that, lots of times it seems very hard to find who is accountable.

You have the same situation here. In other words, this is part of the large bureaucracy of the military services of paying your bills, and for many years the accounting and the financial area was not held accountable for a lot of this. We didn't have audits and we had people signing financial reports at the end of the year that were wrong, sending them over to the Treasury Department. So I think when you passed the CFO Act, you started now to put a framework in there to really start to look for accountability, and that is what I think we have to do here in the next few years.

Senator DORGAN. And so you think a hearing 2 years from today will produce a GAO report that says, boy, we took care of all of this; we finally decided down at DOD that if you are going to pay for something, you might make sure you have got it first? Do you think that we are going to be down the road in solving those problems?

Mr. BOWSHER. I think we should be down the road to solving those problems, I really do. I think we should at some point in time be able to give you that kind of a report, and it is going to have to be your Committee and the other committees here holding the financial leadership of the Defense Department responsible for getting these problems solved, these new systems installed, and getting the job done.

Senator DORGAN. But if we already have a system in place that requires that we match disbursements—

Mr. BOWSHER. And we don't do it.

Senator DORGAN.—and we don't do it, a change in systems is not going to deal with this question. It has to be a change in personnel, and how do you know where you—

Mr. BOWSHER. Well, you need both because what you have got to do is you have got to have some systems that actually allow the people to achieve the matching on a timely basis and get the paperwork properly there. You have got to have the people properly trained. You have got to have enough people to do this job, and that is the kind of plan that is now being put together by the leadership of the Defense Department. You have got to then see if it is being executed; is it actually being accomplished.

In the past, we have had lots of times where we have had plans, you know, to deal with this, but it has never been brought to fruition. It has never been brought to real accomplishments and people have not been held responsible. I think you are raising a very good point, Senator.

Senator DORGAN. I am trying to understand how you do hold somebody responsible.

Mr. BOWSHER. Yes.

Senator DORGAN. This Government is such an amorphous, shapeless bureaucracy, so what we do is we criticize the bureaucracy without ever really understanding that it isn't the bureaucracy here. It is these eight people that made a decision that we are

going to spend billions of dollars to make payments to people that send us invoices without ever checking to see whether we got the product or had the service performed.

Mr. BOWSHER. Yes. Well, I think that this Committee could easily ask the leadership of the Defense Department who are the responsible people at the key points, and we could go out and review that for you.

Senator DORGAN. Mr. Chairman, I think that is exactly what we ought to do.

Mr. BOWSHER. Yes.

Senator DORGAN. These are processes and procedures that first-year accounting students wouldn't view as adequate, and somebody made a decision that we are so busy, we can't do it.

I guess I would like to understand. Did the previous witness err when he said we are giving awards for public service to those who were in charge of systems that were so fundamentally bankrupt in protecting the taxpayers' rights? I don't know the answer to that, but at least on the little thing I was working on—trying to figure out who authorized building a \$27 million building that shouldn't have been built—I still can't figure out who it is, and that is pretty much of a rifle-shot evaluation and I am trying to get your help on that.

Mr. BOWSHER. All right.

Senator DORGAN. I think, Mr. Chairman, that would be a worthwhile pursuit in this Committee, not a search for villains so much as trying to understand what works and what doesn't, and who is presiding over what works and who is presiding over what doesn't. You don't want to put who is presiding over what hasn't worked in charge of a new system and a rededication and recommitment to fix what they screwed up, and so I think that would be a useful pursuit.

Mr. Chairman, I see my red light is on. Thank you for the therapy here. [Laughter.]

Senator DORGAN. It has been therapeutic for me to say it, Mr. Chairman.

Chairman GLENN. If you compare it with a big company—I used to know Ed Cole, who was head of General Motors, and he used to be proud of the fact that General Motors had a bigger budget at that time, at least, some years ago than I think all but eight Nations around the world—a huge budget. They have to have accountability or they are going to be out of business.

Mr. BOWSHER. That is right.

Chairman GLENN. But they are able to move people and fire them; move people that are more efficient into jobs where they are more proficient and things like that. We can't do that under Government employment rules. I don't want to scare everybody in civil service half to death, but I at the same time would ask—I want to ask Mr. Hamre a little bit later whether that would be of any help if we gave some exemption to civil service rules, as we gave early-out authorization to the Pentagon before the rest of the Government had it because they had an immediate problem. When we are talking \$41 billion of taxpayer money here, that is a crisis.

Mr. BOWSHER. That is right. I think we have a crisis in financial management.

Chairman GLENN. I think we have to take some drastic action and if we have got to shuffle people and give some exemptions here to give authority and to get accountability, maybe that is what we have to do. I don't know whether that would work or not, but I think if we have people that either won't or can't or aren't able to adjust to changes being suggested and mandated on top and they just won't do it, then it seems to me like you have to take some pretty drastic action to correct a \$41 billion mistake here. So, anyway, we are going to have to get into some of that.

Back to your written testimony, you were very critical of DOD's handling of the M accounts law, the surplus accounts that used to be merged, and we now have taken care of easing that one out. But under the law, DOD canceled the final \$3.1 billion of M accounts last September and will cancel its first expired accounts under the new rules later this year.

In your opinion, is the law which allows 1 percent of current funds to be used for the unpaid bills from those canceled accounts—is that going to be adequate?

Mr. BOWSHER. Well, we are not really sure, but I think we should let the law stand as it is here for a few years to see how it does work out. What you are trying to do with this new law is to get more accountability here, and we had these M accounts for many years and it was an administrative setup which was, I think, taken advantage of. So now I think the Congress has decided that they want to have more accountability on this, so I think we just have to wait and see how it works out here.

Chairman GLENN. Would you suggest any new legislation this year?

Mr. BOWSHER. No. I would say this year we ought to just wait and see how it is working. Actually, September 1994 will mark the first time that the accounts other than the M accounts will be canceled, so we are just really beginning to get into the new system is the way I see it.

Chairman GLENN. OK. Everyone knows that DBOF has had some problems, and Senator Grassley brought that out on the floor last year with an effort to do away with DBOF and go back to the old system. I know you didn't feel we ought to do that at that time. I talked to you about it at that time, and that did not prevail on the floor. I know Mr. Hamre has talked to Senator Grassley about how he plans to handle these things.

You mentioned that while there has been some progress in handling DBOF, the Pentagon has fallen behind in several important areas. Could you elaborate on those areas and what steps the comptroller needs to take to ensure improvement in the near term?

Mr. BOWSHER. I think this is one of the most important issues that the new comptroller has to deal with, and that is the Defense Business Operations Fund, and they have been missing some of their early milestones here. Dave Nellemann, on my far left, is the one that has been reviewing this for us, so I will ask Dave to give you the details on this, but I think this is a most important area for the next couple of years.

Chairman GLENN. Mr. Nellemann?

Mr. NELLEMANN. As a result of the work that the group did in the Pentagon in October at the request of then Secretary Aspin to

reevaluate DBOF and the direction, a committee came up with an implementation plan which we thought was reasonably realistic and covered most of the problems that had been discussed in previous testimony and reports.

The problem today is that some of the problems of the past continue in terms of slippage against these target dates. That slippage, while not serious at this early stage, does impact some downstream activities which become increasingly important. Our suggestion gets to the heart of this issue of accountability which we were discussing previously. It is our view that there needs to be definite milestones established against which the performance of top management can be measured periodically to make sure that some of the fundamental changes that are essential for the success of DBOF are given the appropriate attention within the appropriate period of time.

The three things that we would like to suggest at this juncture—the first one deals with completing all of the fund policies. Without those policies, there is no way to get everybody to work toward a common goal. We feel that should be accomplished reasonably by December 31, 1994.

Chairman GLENN. That was supposed to be out some time earlier, wasn't it?

Mr. NELLEMAN. Yes.

Chairman GLENN. What was the original schedule on that?

Mr. NELLEMAN. That was originally, I think, due in early spring, about March, if my memory serves me correctly. But doing the job thoroughly and making sure that everyone agrees and signs off on these policies is essential. We feel a more realistic date probably would be the latter part of this calendar year.

Another important factor is the selection of the migration systems that are necessary to support the accounting being done within DBOF. Secretary Perry instructed DFAS to have made that selection by the end of March. That selection still is not complete, to our knowledge, and we would suggest that some time be given to this exercise because of its complexity, but a September 30 date would be appropriate, in our judgment, this calendar year.

Chairman GLENN. Migration meaning how you merge these different accounts, what functions out of what accounts get merged?

Mr. NELLEMAN. Yes. Currently, there are a large number of different systems which are not common, don't use common data definitions, do not talk to one another, are not integrated. As a result, we have a lot of these accounting errors just as a result of the way the systems handle information, which generates some of the problems we were talking about.

Our suggestion there, and part of the plan that Defense has in place, is to select the best of the systems they currently have; rather than building a lot of new systems, get some standardization around those systems, some discipline built around the use of those systems, and try to be able to gain some short-term benefits.

Chairman GLENN. My time is up, but just one question, since it does relate to this specific discussion here. There is a lot of complaining out of the military services regarding prices that are increasing to them not because of costing of this year, but to make up prior year losses. They don't like that. That comes out of their

current budget and they are already pretty well strapped. How do we take care of that?

Mr. NELLEMANN. Well, there is a fundamental problem that has to do with prior year losses and the recovering of those losses in the next year's prices. The underlying need for that kind of approach is to be able to make sure that the cash balances are realistic for going into the new year so that the appropriate amount of cash is there.

It is our view that that request for any additional amount to cover prior year's losses and when there is a cash shortfall should be directed as a separate request for an appropriation as opposed to bearing them in the pricing. Recovering previous year's losses through burying them in the transfer prices does not provide the true benefit that DBOF is seeking, which is to provide cost visibility and hopefully cost control when situations get out of hand. So a separation appropriation which explains why those losses occurred would be a much better treatment.

Chairman GLENN. Senator Dorgan?

Senator DORGAN. Let me just ask another couple of brief questions. In February of 1992, the GAO recommended that the Attorney General of the U.S. or the Secretary of Defense generate and publish a monthly list of all individuals convicted of Defense procurement-related felonies and make this list available to Federal agencies, et cetera.

The next witness, I believe, Mr. Vander Schaaf, is not in agreement with that. In fact, I took that recommendation and added it legislatively to the 1993 appropriations bill, so it is now a part of the law, that requirement. In a response by Mr. Vander Schaaf—I am going to ask him about this and a couple of other things—he talks about the cost of establishing the regulatory requirements and administrative management of a list of persons prohibited from employment by the Defense contractors would far exceed any potential benefit to the Government.

Do you still feel that is a good recommendation and, if so, why?

Mr. COOPER. We think that is a meaningful recommendation. We checked about a month ago on the status of the implementation of that recommendation and the mechanism that you are talking about is really just getting put in place now with the Justice Department. We think it is valuable because it identifies those people who have committed fraud, or whatever, against the Government, and that list is valuable to those people in the Government awarding contracts so they don't make that same mistake again.

Senator DORGAN. You would disagree, then, with the Department of Defense recommendation to discontinue that?

Mr. COOPER. We think our recommendation is still a valid recommendation, yes.

Senator DORGAN. Without that, presumably, Mr. McGill, this energetic fellow who prints invoices, could do whatever time he does, come back out and hitch on with a good Defense contractor and go back to work.

Mr. COOPER. We wouldn't want to see that.

Senator DORGAN. But in any event, that could happen if his name is not on a list some place and somebody is not watching that we are not hiring people previously convicted of fraud, fraud in this

case perpetrated against the Defense Department. Well, I will ask Mr. Vander Schaaf about the Department's questions there.

I wonder if you could just get me a list of information. I wonder if the GAO could provide me with some information about the employee awards that were alluded to earlier in DFAS. We were told earlier this morning that I think three or four \$10,000 employee performance awards were given top management at DFAS. I wonder if you could get me information about how many total awards were provided in DFAS. At least I would like to look at those.

Let me just ask one final question. DFAS is a fairly new organization, but your report here doesn't give me a lot of comfort. You are saying it is new. Obviously, things are changing to try to bring together in one place things that were done in various parts of the armed forces, but this report indicates there are still very serious problems even now that it is all being done under one roof. It probably makes it easier for you to find the problems, but nonetheless these are very significant problems.

How would you characterize what is going on in DFAS just generally speaking, Mr. Bowsher?

Mr. BOWSHER. Well, I would characterize it as an effort that the Defense Department went forward with here a few years ago to try to bring more efficiency, and the way they went forward with it is they tried to grab the existing systems and live with those and they haven't really got the new, modern systems in place. They are still working with a 1968-vintage system there, and so they have a lot of new employees out there in Columbus and what they have got to do is follow through with what I would call the modernization of the process.

I think they have to look, as I said earlier, at the business operations of what they are trying to achieve, in addition to designing the new systems and then getting the people trained on it and everything like that. I will go back to what the Chairman said. If General Motors or these big companies can do it, big Government can do it. In other words, this excuse that we are so big that we really shouldn't have to adhere to good accountability and internal controls shouldn't be accepted at all.

I think that the Government is large, but therefore they have to even more so be held accountable. That is why I think it is so important that we finally are doing audits here to find out what these problems are, and then I think what you need is good plans from the Executive Branch, and then you have got to have performance measurements, milestones, as to how well they are carrying them out. Then, hopefully, at some point in time, whether it is 2 years or 3 years, whatever it is, we can then go out and do a review and come back to this Committee and say things are working well in Columbus. In other words, the documents are being matched. We don't have the unmatched problems, we don't have all these problems that we are reporting on to you today and have been for a couple of years now.

So I think the Defense Department made the initial step of trying to pull it all together, but they haven't followed through very successfully at all with really accomplishing what is needed to be accomplished out there.

Senator DORGAN. I don't mean to minimize the difficulty of the accounting for payments to very large contractors where you have progress payments and work in progress, and trying to measure where you are and what payments should be made. I don't mean to minimize that, but it is hard for me to understand a case of McGill who just says, I am going to rent a post office box and start sending the Government bills and get money from them.

Mr. BOWSHER. McGill's case is what we used to refer to in the private sector as the classic embezzlement; in other words, where he created either a ghost employee or a ghost company, a vendor. Your controls should prevent that. In other words, there is no reason why a McGill situation should happen.

Senator DORGAN. Well, that is why it is so unbelievable.

Mr. BOWSHER. Yes.

Senator DORGAN. I come from a town of 300 people, and I think we only have seven businesses. McGill wouldn't get a penny out of any of those businesses.

Mr. BOWSHER. No.

Senator DORGAN. Not one. He would send them a bill. You know, they would send it to the sheriff.

Now, the second question is ghost employees, and that gets back to the question I asked earlier about following up on the Chairman's questions. This is not rocket science, putting together an accounting system in which you account for people who work for you before you send out a paycheck.

Mr. BOWSHER. That is right.

Senator DORGAN. You can testify from now until the year 2000 about optimism, about systems, and so on, but that is not going to change the questions you have raised about paying people who weren't working and paying ghost employees. That is, I would guess, not a breakdown in the system because they clearly would have had first-year accounting students able to put together a system that checks that. That, again, is a breakdown in whoever is running that system to require the checks necessary to make sure that doesn't happen.

Mr. BOWSHER. That is right.

Senator DORGAN. Do we know who those folks are?

Mr. CONNOR. That partially was a result of unclear accountability between Army and DFAS. You pointed out that DFAS was a new organization. Operating the primary control, comparing the personnel records to the payroll, required cooperation of Army, which maintained the payroll system, and DFAS, which maintained the other system. It required cooperation from both and there was not good accountability. As a result, when those records were compared, neither organization followed up to see why these anomalies were showing up.

Senator DORGAN. But we paid somebody to manage the area that would have said, your job is to follow up. So we paid somebody to do something that didn't get done, and somebody to manage that function as well.

Mr. CONNOR. It should have been done.

Mr. BOWSHER. That is right, yes. Somebody was accountable for that.

Senator DORGAN. And it doesn't matter what we call the organization or what we do to fix it. If we don't change the people who are there who are now not doing what should be done, you will be testifying 2 years from now about the same problem.

Mr. BOWSHER. Right.

Senator DORGAN. That is the problem of accountability.

Mr. BOWSHER. Right, and I think these are areas that could be fixed without any question.

Senator DORGAN. Thank you, Mr. Chairman.

Chairman GLENN. Thank you.

Just a couple of follow-ups here. You talked about you don't need a rocket scientist to design an accounting system. That is attested to by the fact that I think you have identified 161 different accounting systems in the Pentagon, so we have plenty of them over there now. The Army has 43 different accounting systems, I believe, from your testimony.

Mr. BOWSHER. Yes, and these are mostly old systems. In other words, what you have got to do is you have got to modernize. You see, the Defense Department 4 years ago made this big effort and decision to bring it up to the OSD level. They have got to follow through. They have got to have a success here.

Chairman GLENN. I just have one other area I wanted to touch on. We have covered DFAS and the Army payroll debt collection and debt cancellation errors; number two, undistributed and unmatched disbursements, underreported in both areas, and fraud; number three, contractor overpayments—overpayments undetected by DOD, basically—and backlogged contract reconciliations; number four, the M accounts, expired appropriations; five, DBOF, which is an \$85 billion operation. I don't think I mentioned that earlier—an \$85 billion operation in DBOF.

Then the last one is the one I wanted to touch on just briefly, computer systems, the CIM system, the Computer Information Management system. Under CIM come such things as command and control, finance, materiel management, distribution, procurement, and human resources. The total cost of all those things runs about \$88 billion a year, and CIM was supposed to set up our accounting system that was going to let us really just hit the right buttons and we could learn whatever we wanted to know in each one of those different areas.

Now, it has been worked on for some 4 years over there. Can you give us your view of it and what we can expect and how we are going to solve some of the CIM problems?

Mr. BOWSHER. OK. Dave Nellemann, again, has been the one that has been in charge of our work on the CIM work, so let me ask Dave to answer that question.

Mr. NELLEMANN. As you can see from our report, there has been some progress in some areas. The one that is at the tail-end which is kind of surprising is C cube die, which is where the responsibility for the overall CIM effort rests. The problems that still persist are, I think, first the priority that is being given to CIM is very low. As a consequence, the amount of management attention and emphasis being given to CIM is very uneven.

In our report, we call for greater prioritization of the CIM effort, the need to be able to develop a much more cohesive approach.

Chairman GLENN. If I could interrupt, we have had testimony in the past that said that they don't expect a lot of the problems to be solved until CIM is implemented.

Mr. NELLEMANN. That is right.

Chairman GLENN. Do you agree with that?

Mr. NELLEMANN. I would agree that some of the problems probably should be solved in the short term. Some of the things we talked about today are problems with discipline, problems with data errors, problems of trying to get good financial reports, which are all Accounting 101 kind of issues and require a much more intense management effort.

We are not talking about major systems upheaval here, but downstream, in order to get the kinds of efficiencies and savings that should be obtainable, we are talking about more streamlined, integrated systems that are necessary. To do that, we need a much more coordinated approach than has been taken to date within CIM.

Chairman GLENN. We have also been told that they expect to take 10 years, perhaps, to implement CIM. Do you have an observation on that? Can't we do better than 10 years? If it is that important to getting control of the financial management of the biggest expenditure of Government, the Department of Defense, can't we do better than 10 years? Does it take that long to put CIM into effect?

Mr. NELLEMANN. If we continue to operate the same level of intensity, it probably is going to take longer than 10 years. The priority to the Department is the one that needs to be reexamined, and the emphasis being placed on CIM has to be much more intense. There has got to be much more top management commitment and involvement in the overall CIM effort to be able to cut that time frame.

Chairman GLENN. Do you think it is as critical as some people have indicated, that we really have to have that if we are going to get control?

Mr. NELLEMANN. I think it is kind of half and half. I think modernization of the systems is essential. You need to continue to invest in these areas in order to take advantage of new technology and get the savings that are out there. But there are some fundamental changes that need to be made, too, and these fundamental changes involve more discipline over the use of current systems; the selection of the best of the current systems that exist, the legacy systems; the management follow-up over these systems and the proper use of those systems; and the need to stop debating over that issue endlessly, but to be able to get on with the issues and follow a well thought-through path.

Chairman GLENN. Thank you. We are going to have to move along time-wise here. We have other witnesses this morning. Thank you, Mr. Bowsher and all of you at the table this morning. We may have additional questions for you. We would appreciate your response, as usual, and we appreciate your working with us on these very important matters. Thank you very much.

Mr. BOWSHER. We will be pleased to continue, Mr. Chairman.

Chairman GLENN. Thank you.

PREPARED STATEMENT OF CHARLES A. BOWSHER

FINANCIAL MANAGEMENT

FINANCIAL CONTROL AND SYSTEM WEAKNESSES CONTINUE TO WASTE DOD RESOURCES
AND UNDERMINE OPERATIONS

Mr. Chairman and Members of the Committee:

It is a pleasure to appear before you today to present our views on the Department of Defense's (DOD) efforts to improve accountability and controls over operations. Given the vast amount of resources that are entrusted to DOD, it is imperative that the Department have effective financial management and internal control systems. As I testified before this Committee last July, our reports and testimonies over the last several years have disclosed widespread and significant problems with DOD's financial management operations, systems, and controls.¹

Recently, we have seen encouraging signs from DOD's new leadership, including frank admissions of financial management problems and a heightened interest in bringing about their resolution. In a February 1994 statement presenting DOD's fiscal year 1995 budget, the Secretary of Defense acknowledged "we need to reform our financial management. It is a mess, and it is costing us money we desperately need." That kind of leadership commitment is essential to correcting the problems I am going to discuss.

The severe shortcomings in DOD's financial operations that I will discuss today further demonstrate the importance of expanding the Chief Financial Officers (CFO) Act requirements that I addressed in February before this Committee.² Specifically, expanding and making permanent the requirement for audited financial statements in DOD, as well as for agencies governmentwide, is critical to ensuring basic accountability and to making available the facts needed to run our government more efficiently. As requested, I will focus my remarks on updating you on the status of DOD's progress in addressing problems in five important areas.

—Contractor Overpayments

During the first 6 months of fiscal year 1993, DOD received \$751 million in payments returned by contractors. Our analysis has shown that such returns primarily represent overpayments made through breakdowns in government controls or errors. Weak controls over disbursements also permitted illegal payments—such as \$3 million in fraudulent payments to a former Military Sealift Command supply officer.

—Military Payroll

Improper Army payroll payments have resulted in an estimated \$7.8 million of debts owed to the government. Investigations to date have confirmed that six "ghost" soldiers and 76 deserters received unauthorized pay.

—Unmatched Disbursements

DOD has identified approximately \$19 billion in unmatched disbursements. Such disbursements represent payments for goods and services which have not been matched with related obligations. Until this condition is corrected, errors or illegal acts may be more likely to occur and not be detected.

—"M" Accounts

Continuing problems with DOD "M" account appropriations may have resulted in overexpending five "M" accounts by \$152.7 million as of the end of fiscal year 1993.

—Defense Business Operations Fund

DOD has made some progress in improving DBOF operations; however, most previously reported problems with the Fund continue. Current prices charged to Fund customers do not reflect actual operating costs for the reporting period. In addition, DOD needs to assess whether the Fund needs to have a full-time director responsible for overseeing its implementation and day-to-day operations.

I will also provide our concerns on the need for a strategic plan to guide DOD's financial system improvement efforts under its Corporate Information Management initiative.

¹ *Financial Management: DOD Has Not Responded Effectively to Serious, Long-Standing Problems* GAO/T-AIMD-93-1, July 1, 1993.

² *Improving Government: GAO's Views on H.R. 3400 Management Initiatives* (GAO/T-AIMD/GGD-94-97, February 23, 1994).

**EFFORTS UNDERWAY TO IMPROVE DETECTION AND COLLECTION OF CONTRACTOR
OVERPAYMENTS**

A dramatic indicator of the adverse effects of poor controls over the disbursement process is the dollar value of payments returned to the government. Last July, we testified that the DFAS-Columbus Center received \$751 million from DOD contractors during the first 6 months of fiscal year 1993. Our report on those payments,³ which is being released today, shows that most of the payments were returns of contract overpayments.

Our examination of \$392 million of the \$751 million returned by contractors disclosed that about \$305 million, or about 78 percent, were overpayments. DFAS-Columbus overpaid contractors principally because it either (1) paid invoices without considering previous progress payments or (2) made duplicate payments. Other errors, such as government contractual errors, also contributed to the overpayments.

Underscoring our concern about the amount of overpayments is the fact that the vast majority of the overpayments we examined were detected by contractors, rather than as a result of existing DFAS controls. In any situation in which the government must rely on contractors rather than its own controls to detect and collect overpayments, the risk is greater that losses will result from undetected, or unreturned overpayments.

The DFAS-Columbus collection process also did not ensure prompt return of overpayments identified and reported by contractors. In some cases, contractors planned to return overpayments but were told to hold them until the contracts could be reconciled and demand letters issued. The standard demand letter allowed an additional 30-day grace period to return an overpayment before interest was assessed. The interest cost associated with these overpayments, even when they are returned, can be significant. To illustrate, for about \$240 million in returned overpayments for which we could determine the date the disbursement was made, we estimated the interest costs were about \$2.3 million. These overpayments were outstanding an average of 108 days, and about 40 percent were outstanding more than 90 days. DFAS-Columbus issued a policy in November 1993 requiring that contractors be asked to immediately return reported overpayments.

DFAS's primary method of detecting overpayments is through detailed examinations—known as reconciliations—of contracts with known or suspected problems. DFAS-Columbus has assigned about 130 personnel to conduct contract reconciliations. They reconciled 6,619 contracts in fiscal year 1993. However, as of December 1993, DFAS-Columbus officials had identified 6,603 "problem" contracts—contracts with payments exceeding available funds, or contracts with other problems, such as missing payments or other pertinent contractor information—that had not been reconciled. We understand that DFAS is hiring additional personnel to deal with the backlog of contracts that have not yet been reconciled.

In addition to its own reconciliations, DFAS engaged a public accounting firm to reconcile selected "problem" contracts. For the period of October 1990 through November 1993, the accounting firm reconciled approximately 4,300 contracts and identified the following.

—Contractors owed about \$208 million to the government, and an additional \$52 million in possible contractor debts was still under review in November 1993.

—The government owed about \$61 million to contractors.

Based on the accounting firm's reconciliations, DFAS issued demand letters to contractors for \$175 million and collected about \$73 million as of November 1993. The firm also reported that approximately \$17 million of contractor debts may not be collectable for one or more reasons, including the bankruptcies of contractors who owed \$8 million.

DOD is currently considering a number of ways to strengthen existing internal control procedures designed to prevent overpayments and to more rapidly detect such payments when they occur. Also, initiatives are underway to reform and streamline the complex regulatory policies and procedures that affect contract payments. We will consider the effectiveness of these actions as part of our continuing work on contract overpayments for this Committee. As noted in following sections of this testimony, DOD's internal controls over disbursements have a number of shortcomings, including an increased risk of fraudulent payments. Because of the large dollar amounts at risk, DOD should view the need for corrective actions in this area with an increased sense of urgency.

³DOD Procurement: Millions in Overpayments Returned by DOD Contractors (GAO/NSIAD-94-106, March 14, 1994).

WEAK CONTROLS PERMITTED MILITARY SEALIFT COMMAND FRAUD

The overpayments to contractors I just discussed occurred and went undetected because existing controls were not effective. Control breakdowns have also contributed to fraudulent payments. The recent disclosures concerning \$3 million of false claims by a former Military Sealift Command supply officer clearly illustrate the devastating and costly effects that can result from internal control deficiencies. While the overall amount of the fraudulent payments in this case is certainly disturbing in itself, other circumstances surrounding this case may provide even more insight into the poor condition of a key portion of DOD's internal control structure.

In this case, a former supply officer of the Navy's Military Sealift Command, working primarily from outside Navy and DOD financial organizations, established a fictitious contracting company and received payments for over a hundred bogus invoices. Military Sealift Command personnel discovered his illegal activities after he submitted several invoices for large amounts for parts purportedly delivered to a decommissioned vessel. Had he not submitted relatively large dollar invoices related to a decommissioned vessel, he may have been able to continue to carry out his scheme.

At least three Navy and DOD activities were involved in reviewing and accounting for payments on 108 fraudulent invoices (and related bogus purchase orders) for ship parts that were neither ordered nor delivered. The former supply officer carried out his illegal scheme for almost 4 years without raising critical questions because controls were inadequate to ensure that (1) parts were ordered using authorized purchase orders, (2) parts were accepted by authorized Navy personnel, and (3) payment requests were valid. Also, the Military Sealift Command did not match individual disbursements with related obligations, another control procedure which may have triggered an investigation leading to the disclosure of this fraudulent scheme. If basic internal controls were in place, the fraudulent payment requests would—at a minimum—have been identified sooner, thus saving millions of dollars. Basic controls are fundamental for any entity to ensure that payments it makes accurately correspond to goods and services actually received.

Another disturbing aspect of this case is that the fraudulent scheme was perpetrated in a relatively unsophisticated manner—the former supply officer with general knowledge of documentation requirements for contract payments, simply submitted bogus purchase orders and invoices which included fraudulent receipt and acceptance information. In fact, the perpetrator even incorrectly completed the documents on several occasions, and the Navy provided him instructions on how to prepare and submit “properly documented” invoices.

The relatively unsophisticated method used to perpetrate this fraud—like the case of the Air Force base accountant which I discussed at your hearing last July—illustrates just how weak DOD's disbursement controls are. Also, the fact that these cases were discovered by chance, and not through detection by internal controls, raises the possibility that more schemes may be ongoing and undetected. DOD officials have informed us that corrective actions intended to improve controls to prevent future occurrences of this sort are scheduled to be implemented by the end of this fiscal year. We will monitor these actions.

STATUS OF ACTIONS AND INVESTIGATIONS RESULTING FROM IMPROPER ARMY PAYROLL PAYMENTS

In my July 1993 testimony before this Committee,⁴ as well as our related report on problems with Army's military payroll,⁵ I discussed an estimated \$6 million in unauthorized payroll payments. Since that time, we have been monitoring DFAS's efforts and working with the Army's Criminal Investigation Command (known as CID). CID is responsible for conducting criminal investigations involving Army personnel. As of March 1994, DFAS estimated that the amount owed the government as a result of improper military payroll payments was about \$7.8 million, or about 30 percent over the amount initially identified. Included in these amounts are payments to “ghost” soldiers and deserters.

Today, I will update you on progress of the ongoing efforts to (1) prosecute individuals in connection with improper payroll payments, (2) identify additional overpayments, (3) collect debts owed the government, and (4) correct control and system weaknesses.

⁴(GAO/T-AIMD-93-1, July 1, 1993).

⁵*Financial Management: Defense's System for Army Military Payroll is Unreliable* (GAO/AIMD-93-32, September 30, 1993).

But I would caution that this situation is far from being resolved. Research to determine the total debt owed the government as a result of improper DOD payroll payments, as well as in each of the other areas I just mentioned, is still ongoing.

Results of Investigations

As of March 1994, investigations have shown that four individuals received payroll payments for six "ghost" soldiers, and 76 deserters from the Army were improperly paid. The "ghost" soldiers represent fictitious pay accounts fraudulently established by finance clerks manipulating the payroll system. To date, four individuals have been incarcerated, and prosecutions are pending on 10 other individuals.

Details on the circumstances surrounding 10 examples of fraudulent Army payroll payments are provided in attachment I. The following two examples provide a brief description of circumstances involving fraudulent Army payroll payments to a "ghost" soldier and a deserter.

- A finance clerk created a fictitious payroll account in the payroll system using a fabricated name and social security number and collected over \$71,000.
- Another soldier deserted in October 1991 yet continued to receive over \$43,000 in payroll payments through May 1993.

DFAS, either at its own initiative or in response to GAO requests, has begun identifying additional recipients of improper payroll payments. These cases are in various stages of analysis or investigation.

Actions to Recover Indebtedness

As of March 1994, DFAS records showed that collection efforts have recovered over \$1.7 million of the estimated \$7.8 million owed the government because of improper Army payroll payments. Approximately \$900,000 of this amount was recovered as a result of CID investigations. The remaining \$800,000 was recovered through DFAS's normal debt collection process.

In addition, DFAS determined that its debt management system did not include an estimated \$27.5 million in additional payroll debt not related to the identified overpayments. According to DFAS officials, this occurred because of a breakdown in the process of passing debt information from the payroll system to the debt management system. Because the debt had not been passed to the debt management system, DFAS could not initiate action to collect the \$27.5 million. Included in this amount was a final separation check incorrectly issued in the amount of \$836,919 instead of the correct amount of \$183. According to DFAS officials, DFAS now has procedures to (1) identify and validate all checks in excess of \$6,000 before issuance and (2) ensure that the correct information is entered in the debt management system so that collection efforts can be initiated.

Status of Corrective Actions

To date we have identified a variety of causes for the breakdowns in payroll internal controls. We have also noted that the personnel and payroll systems were not integrated. Without an integrated personnel and payroll system, comparison of automated payroll and personnel files is a normally required control to detect improper or fraudulent payroll payments. To operate this control effectively requires cooperative action by both DFAS, which has responsibility for processing and accounting for payroll payments, and the Army, which has responsibility for authorizing and processing personnel actions that provide the basis for payroll payments. However, we found that this control was not in place at the time of our review. We have also found that Army personnel were not following established procedures, in particular requirements concerning timely submission of personnel actions.

DFAS efforts to date have focused on identifying and collecting debts owed the government as a result of improper Army payroll payments. According to DFAS officials, a number of other efforts are underway to improve controls and strengthen procedures in this area. In addition, we understand that the Army Audit Agency has included a review of controls over the payroll process as part of its audit of the Army's fiscal year 1993 financial statements and is expected to provide further insights into the underlying causes of these internal control breakdowns.

However, significant unresolved issues remain in this area. The integration of payroll and personnel systems will require a sustained commitment by both DFAS and Army leadership. In addition, DFAS and the Army must work cooperatively to ensure that both personnel and related payroll transactions are processed in accordance with established policies and procedures. It is also critical that planned corrective actions include analyzing and investigating the potential cases of payroll improprieties that remain with DFAS and CID, including the estimated 500 cases CID had pending investigation as of March 1994. Based on current resource levels and system access, a CID official estimated that 3 years would be required to complete investigations on the remaining cases.

BILLIONS OF DOLLARS OF DISBURSEMENTS CANNOT BE PROPERLY MATCHED TO OBLIGATIONS

Unmatched disbursements can have serious consequences. Tolerating their existence in large volumes can help hide the kinds of erroneous or illegal contractor payments I discussed previously. In June 1993, we reported that as of December 19, 1992, one of the Navy's primary accounting systems contained \$13.6 billion of unmatched disbursements.⁶ Unmatched disbursements represent payments for goods and services which have not been matched with related obligations.

We found that Navy's unmatched disbursements were caused by a variety of problems, including lax compliance with internal controls over both the recording of obligations and disbursements and the detection and correction of identified errors. Not matching disbursements with obligations significantly increases the risk that fraudulent or erroneous payments may have occurred without being detected. In addition, unless disbursements are properly matched, agencies may not have the accurate information needed to ensure that cumulative amounts of disbursements do not exceed appropriation and other legal limits. In other reports, we have noted that the Army and Air Force also had significant problems in properly matching disbursements with obligations.⁷

In response to our work, DOD established a special team in July 1993 to address unmatched disbursements DOD-wide. Early on in its work, the team defined two general categories of disbursements—unmatched and undistributed—upon which to concentrate its efforts and to establish "benchmarks" for measuring its success in resolving disbursement problems. The team defined an unmatched disbursement as a disbursement which was not matched to a corresponding obligation because of an error, such as inaccurate or incomplete accounting data. These transactions were considered to be a problem.

The team defined an undistributed disbursement as a transaction that had not yet been through the matching process. The team did not view such transactions to be problem transactions because DOD had not yet made an attempt to match them to specific obligations. Instead, the team viewed these transactions as a normal consequence of the DOD disbursement process. However, the team did not have sufficient information on those disbursements to conclusively determine whether they represented problems. Such information would include the number, dollar amounts, and age of the transactions. The team indicated that when it got this type of information, it might reconsider whether or not undistributed disbursements are problem transactions.

Using the two general categories, the team identified approximately \$41 billion of disbursements within DOD as of March 1993—\$22 billion in undistributed or non-problem disbursements, and \$19 billion in unmatched or problem disbursements. As of January 1994, the team reported that its reconciliation efforts had reduced the amount of DOD's problem transactions from a DOD-wide total of \$19 billion in March 1993, to \$12.6 billion.

We are concerned about the team's general characterizations of disbursements. First, we are concerned with the team's view that undistributed disbursements were not a problem, because the data needed to make that determination was not available. Specifically, we believe that some undistributed disbursements may be problem transactions. For example, if disbursements are not promptly distributed to the accountable activity responsible for matching them to an obligation, then they may mislead financial and program managers about the actual value of outstanding obligations and the total amount of expenditures. As part of our ongoing work, we plan to analyze the undistributed accounts to determine how long they have been in the undistributed category.

Secondly, we do not believe that the team's definitions included all of the various types of disbursements that should have been considered as problem transactions. Our preliminary analysis of how the unmatched or problem transactions were identified and categorized disclosed that billions of dollars of problem transactions were either excluded from the \$41 billion universe of disbursement transactions or inaccurately reported. As a result, we believe the amount of problem transactions was probably significantly higher than both the \$19 billion initially identified by the team and the \$12.6 billion currently reported.

⁶ *Financial Management: Navy Records Contain Billions of Dollars in Unmatched Disbursements* (GAO/AFMD-93-21, June 9, 1993).

⁷ *Financial Management: Strong Leadership Needed to Improve Army's Financial Accountability* GAO/AIMD-94-12, December 22, 1993) and *Financial Audit: Air Force Does Not Effectively Account for Billions of Dollars of Resources* (GAO/AFMD-90-23, February 23, 1990).

For example, we found that DFAS-Denver was not including billions of dollars of negative unliquidated obligations as problem disbursements.⁸ When DFAS-Denver determined the amount of negative unliquidated obligation balances, it combined the negative and positive unliquidated obligation balances on each contract to arrive at a net figure. For instance, if the contract had \$15 million of negative unliquidated obligations and \$5 million of positive unliquidated obligations, DFAS-Denver would net the two balances and report \$10 million of problem disbursements for the contract. However, if the positive and negative values were reversed, no problem transactions would be reported for the contract since the net value of combining the positive and negative balances would produce a positive obligation balance of \$10 million. In both cases, the value of problem disbursements was \$20 million, and thus significantly understated.

Recognizing that reporting net obligation balances masks the true value of problem transactions, we requested that DFAS-Denver develop a special computer program to identify the absolute value of negative unliquidated obligations for each contract. This special run disclosed that as of March 1994, Denver's records contained about \$7 billion of negative unliquidated obligation balances or about \$6.4 billion more than it had previously reported in February 1994. DFAS-Denver officials acknowledged that reporting net amounts dramatically distorts the magnitude of the problem. The officials agreed with our position and have indicated that they will now require unliquidated obligations be reported as absolute values.

As this Committee has requested, we are beginning an assignment to monitor DOD's efforts and progress in resolving these disbursement problems. We will keep the Committee fully informed of the progress and effectiveness of DOD's actions. Because of the far reaching nature of these problems, it is critical that DOD actions comprehensively focus on and address these problems.

DOD HAS CONTINUING PROBLEMS WITH "M" ACCOUNTS

We testified before this Committee last July that due to years of neglect, inadequate systems, and poor management, DOD could not properly implement provisions of the "M" account legislation (Public Law 101-510). For example, we pointed out that the Air Force did not have adequate controls over "M" accounts, and could not adequately document hundreds of millions of dollars in budget authority it restored to correct what it characterized as over 30 years of accounting errors. Unfortunately, DOD's problems with accurately accounting for and reporting on its "M" accounts continue.

On September 30, 1993, as required by law, DOD canceled \$3.1 billion in "M" account funds which represented the last remaining "M" account budget authority available for paying DOD's bills. Any future payments related to these canceled appropriations will have to be made from current year funds. In February 1994, we notified the Secretary of Defense that we had identified five DOD "M" accounts that, according to DOD financial reports, may have been overexpended by \$152.7 million as of September 30, 1993.⁹ We pointed out that an expenditure or obligation in excess of an appropriation or fund balance violates the Antideficiency Act, and that any violation must be immediately reported to the President and the Congress. DOD has since informed us that the five appropriations may be overexpended, and we understand it is investigating whether Antideficiency Act violations have occurred.

LIMITED PROGRESS IN IMPLEMENTING DOD'S FINANCIAL MANAGEMENT IMPROVEMENT INITIATIVES

DOD has had initiatives underway for several years that are intended to fundamentally change the structure used to support its administrative operations and financial systems. However, we have seen only limited progress in these initiatives since I testified before this Committee last July.

Initiatives such as the Defense Business Operations Fund and DFAS's efforts under the Corporate Information Management initiative, are intended to improve the effectiveness of DOD's financial management operations and to produce cost savings and other efficiencies. DOD has transferred much of the responsibility, author-

⁸Transactions result in negative unliquidated obligations when recorded expenditures exceed recorded obligations. We have issued several reports on negative unliquidated obligations at DOD: *Financial Management: Air Force Systems Command is Unaware of Status of Negative Unliquidated Obligations* (GAO/AFMD-91-42, August 29, 1991); *Financial Management: Army Records Contain Millions of Dollars in Negative Unliquidated Obligations* (GAO/AFMD-91-41, May 2, 1990); and *Financial Management: Air Force Records Contain \$512 Million in Negative Unliquidated Obligations* GAO/AFMD-89-78, June 30, 1989).

⁹Letter to the Hon. William J. Perry, the Secretary of Defense (GAO/AIMD-94-84R, February 24, 1994).

ity, control, and resources for financial management operations and systems from the military services to the Office of the Secretary of Defense (OSD) through these initiatives. Management of the component funds, however, remains in the hands of the military services.

Need to Strengthen Management of the Defense Business Operations Fund

In October 1991, OSD implemented the Defense Business Operations Fund, which consolidated the nine existing industrial and stock funds operated by the military services, DOD, DFAS, and several smaller DOD organizations. The Fund's primary goal is to focus the attention of all levels of management on the total costs of carrying out certain critical DOD business operations.

The Fund has a business relationship with its customers, primarily the military services, that is modeled after private sector business operations. DOD estimates that in fiscal year 1995, the Fund will generate revenues of about \$77 billion, equal to those of the world's largest corporations.

Since the Fund was first proposed in February 1991, we have monitored and evaluated its implementation and operation. We continue to support the Fund's underlying concepts. However, as we recently reported, DOD has not yet achieved the Fund's objectives because

- policies critical to the Fund's operations either were not developed or needed revision;
- financial reports were inaccurate; and
- the cost accounting systems were fragmented and costly to maintain and did not provide the cost information necessary for managers to better control costs.¹⁰

On September 24, 1993, the Deputy Secretary of Defense and the Secretaries of the Army, Navy, and Air Force approved the Defense Business Operations Fund Improvement Plan, which consists of 56 actions and 183 tasks aimed at improving the Fund's operations and addressing known deficiencies. We believe the plan offers a potentially useful blueprint for achieving the goals for which the Fund was established. However, achieving the necessary actions within the planned milestones will require strong commitment and the active support of senior OSD management and the military services. While we believe DOD's overall approach is a step in the right direction, we are concerned about the following issues.

- DOD currently estimates that at the end of fiscal year 1994, the Fund will have approximately \$1.7 billion in accumulated operating losses. According to DOD's pricing policy, future years' prices are to be adjusted to recover prior year losses. However, setting current prices to recover prior losses is inconsistent with a basic tenet of the Fund—that current year prices should reflect the actual cost incurred in providing that year's goods and services—and diminishes incentives to reduce the cost of the Fund's operations. Instead of this practice, we have previously recommended that DOD be required to justify recovering any prior year losses as part of the appropriation process.¹¹

Because of persistent problems with the Fund's operations, we suggested in an October 1993 letter to the Deputy Secretary of Defense that DOD appoint a full-time Fund director to be responsible for overseeing the Fund's implementation and day-to-day operation.¹² In response to that letter, DOD stated that instead of a Fund director, it had appointed the DOD Comptroller to oversee the implementation of the Fund's improvement plan. The Comptroller chairs the Defense Business Operations Fund Corporate Board. The Corporate Board is comprised of functional and financial senior executives who are to represent the interests of the Fund and its customers. This approach to managing the implementation of the Fund is similar to past approaches, which were not effective. Decisions were either not made promptly, or not always implemented. Responsibility and authority for actions were diffused. Consequently, we believe the Secretary of Defense needs to closely monitor the effectiveness of this management approach.

Strategic Planning for Financial Systems

Today we are releasing a report on our concerns with the implementation of OSD's Corporate Information Management (CIM) initiative.¹³ OSD began its CIM initiative in October 1989, with the goal of improving all of its business processes and information systems to promote greater efficiency in response to increasing

¹⁰Financial Management: DOD's Efforts to Improve Operations of the Defense Business Operations Fund (GAO/T-AIMD/NSIAD-94-146, March 24, 1994).

¹¹(GAO/T-AIMD/NSIAD-94-146).

¹²Letter to the Deputy Secretary of Defense, (GAO/AIMD-94-7R, October 12, 1993).

¹³Defense Management: Stronger Support Needed for Corporate Information Management Initiative to Succeed (GAO/AIMD/NSIAD-94-101, April 12, 1994).

budget pressures. The CIM program encompasses all DOD functional areas, such as material management, procurement, human resources, and finance. DFAS is responsible for implementing improvements in the business processes and information systems for the finance and accounting area.

The approach identified for implementing CIM requires both the streamlining of business processes and the development of modern information systems. DFAS's approach is to select and adapt as an interim step the best existing systems for use as "migratory"¹⁴ financial systems to be followed eventually by "target" systems.

We are concerned that while DFAS has made some progress in selecting and modifying financial migratory systems and developing target systems requirements, it does not have a comprehensive strategic information systems plan. We believe that such a plan is necessary to ensure that (1) the migratory finance and accounting systems are adapted and implemented in a coordinated fashion and (2) the migratory systems' implementation will facilitate the transition to streamlined, integrated target systems. This plan is also needed to incorporate business process reengineering activities and to ensure that target systems will include standard data elements.

DFAS officials have agreed that an overall plan is needed and have informed us that it is currently being drafted. We will continue to monitor the DFAS system integration and modernization effort and keep this Committee advised of its status.

STATUS OF DOD'S EFFORTS TO IMPLEMENT CFO ACT REQUIREMENTS

In my view, the CFO Act, which was enacted under the leadership of this Committee, has focused attention on the improvements needed in DOD's financial management. DOD's implementation of the act has yielded a number of positive results. However, for an entity as large and complex as DOD, the full realization of all potential benefits will require a significant period of time. A summary of the status of DOD's implementation of the CFO Act is provided in attachment II. However, I would like to now briefly mention some highlights of financial audits done in DOD pursuant to the CFO Act.

- DFAS and the military services have made progress in preparing financial statements and the extensive related disclosures and supplemental information. The Department of the Army has demonstrated proactive involvement from top management officials in resolving financial problems disclosed by the audits.
- The CFO Act audits have provided overwhelming evidence of the need to deal with widespread and severe financial management weaknesses. They have identified billions of dollars of erroneous disbursements, waste, mismanagement, fraud, and misappropriation. Calling attention to such problems is a necessary and significant "first step" in devising and implementing actions to improve financial management systems, operations, and controls.
- Implementation of the CFO Act has brought about some improvements in the extent, quality, and timing of financial information available to congressional decisionmakers and DOD managers. For example, the Army established quality assurance processes to ensure that management information in its real property system is more accurate. These processes are intended to enhance the reliability of future budget requests and information used in the base closure and realignment reviews.
- In certain instances, opportunities to make short-term improvements to financial management systems and controls have been identified. Audits conducted at Army, Air Force, Navy, and DFAS organizations highlighted the importance and necessity of solving the serious problem of unmatched disbursements. The audits prompted DOD officials acknowledge unmatched disbursements as a material weakness.
- DOD audit organizations have devoted substantial efforts and resources to conducting the audits required by the CFO Act. Over the past few years, hundreds of DOD auditors have been formally trained in conducting financial audits while others received on-the-job training by working on financial audits. I would like to commend the DOD audit community—the Inspector General, Air Force Audit Agency, Army Audit Agency, and Naval Audit Service—for their commitment and efforts to carry out the audit responsibilities mandated by the act.

In addition, as I discussed in previous testimonies before this Committee, the CFO Act provides a blueprint for essential financial management reforms, such as those proposed by the Administration's National Performance Review and the Gov-

¹⁴ Under its "migration strategy," DOD will select one (or more) of the existing systems in each functional area as a standard (migratory) system for all DOD entities with activities in that area.

ernment Performance and Results Act of 1993. Specifically, the perspective obtained through annual agency financial reports under the CFO Act is consistent with the annual report on the government's finances called for by the National Performance Review. Annual CFO Act audits also provide an important vehicle for monitoring the DOD efforts to resolve the weaknesses I discussed today.

MORE FORTHRIGHT ACKNOWLEDGEMENT OF FINANCIAL MANAGEMENT PROBLEMS

In the past, we have been highly critical of DOD's failure to acknowledge the fundamental and pervasive internal control, financial system, and accounting problems in many critical areas of its operations. Most recently, I expressed such concerns in an April 1993 letter to former Defense Secretary Aspin.¹⁵ In that letter, I took exception to the Secretary's fiscal year 1992 reporting pursuant to the Federal Managers' Financial Integrity Act. The Secretary's report concluded that, overall, the DOD's controls and accounting systems provided reasonable assurance that the goals of the act were being achieved. I pointed out that the report's conclusion was inconsistent with the litany of internal control and accounting system weaknesses discussed in the details of his report and with the findings presented in numerous audit reports. In this respect, I noted that GAO and other auditors' reports had highlighted long-standing management, internal control, and accounting system deficiencies that weakened DOD's ability to safeguard, manage, and control the hundreds of billions of dollars of resources entrusted to it.

While I still have some concerns with aspects of DOD's reporting, its latest annual Federal Managers' Financial Integrity Act report to the President and the Congress is much more candid than previous reports. Specifically, the Secretary's fiscal year 1993 report acknowledges 58 additional material weaknesses—many in critical areas of DOD's operations. For example, DOD now acknowledges material weaknesses in

- obtaining reliable information on its major equipment items that is needed to determine maintenance requirements and redistribute equipment,
- ensuring that Army Reserve personnel do not receive duplicate salary payments,
- controlling access to its automated systems, and
- providing adequate contingency plans specifying actions needed in the event of catastrophic events at its major data processing centers.

Also encouraging are DOD's frank admissions in the former Secretary's annual management report to the President and the Congress.¹⁶ In the report, the Secretary acknowledges that financial management complacency has permitted pervasive and harmful weaknesses in DOD financial management operations. The report also describes adverse consequences that resulted from these weaknesses and recognizes that the waste these weaknesses cause reduces combat capability and damages the DOD's credibility with the public and the Congress. Specifically, the report recognizes the following:

Accounting, business-type efficiency, and indirect support functions were secondary considerations of top DOD leaders. Now, however, this limited attention to financial management threatens U.S. combat power in two ways: (1) financial management problems waste money that is needed more than ever to sustain sufficient combat power and (2) whenever mismanagement surfaces, understandable congressional and public response is to often reduce overall DOD spending by more than would otherwise be the case.

The [DOD] financial management community adapted to shortcomings and lacked a sense of urgency for correcting them. Senior DOD leaders did not consider financial management shortcomings as serious as those in other areas.

The [DOD] has serious, long-standing financial management problems. If DOD does not candidly acknowledge that reality, it cannot expect support in solving those problems and confidence in the overall stewardship of defense matters will be undermined.

With these forthright admissions of serious weaknesses, DOD—for the first time—is in a better position to comprehensively and realistically address them.

* * * * *

Mr. Chairman, DOD has had serious financial management problems for decades. The problem areas I discussed today are representative of the problems DOD has

¹⁵Letter to the Hon. Les Aspin, the Secretary of Defense, (GAO/AFMD-93-61R, April 27, 1993).

¹⁶Annual Report to the President and the Congress, Les Aspin, Secretary of Defense, January 1994.

been facing for years. It is important to recognize that turning this situation around will be a daunting and formidable challenge. Most importantly, strong sustained support and commitment by DOD's top leadership and its managers at all levels will be required.

DOD has now taken the first step to making these fundamental changes. The new DOD leadership's recent recognition of serious problems, as well as their heightened interest in bringing about the resolution of these problems is encouraging.

However, translating this acknowledgement into needed actions will require not only sustained management commitment, but also the requisite investment in people and systems. Cost awareness and reliable financial reporting must become ingrained in DOD's management culture. I look forward to working with the new leadership in DOD, as well as with this Committee, as we strive to achieve our mutual goal of a better managed and fully accountable Department of Defense. This Committee's continuing oversight has been instrumental in helping focus DOD leadership's attention on critical financial management areas in need of improvement. Such oversight will continue to be an essential element in assuring the prompt, effective resolution of the fundamental financial management weaknesses facing DOD.

Mr. Chairman, this concludes my statement. I will be glad to answer any questions you or other Members of the Committee may have.

ATTACHMENT I

EXAMPLES OF CASES IDENTIFIED AS IMPROPER PAYROLL PAYMENTS

Example 1

An Army finance clerk created two fictitious pay accounts with allotments transferring approximately \$100,000 in pay to the clerk's bank accounts. To create one of the fictitious pay accounts, the finance clerk manipulated the pay system to create a fictitious soldier ("ghost"). The second fictitious account was established by reactivating the pay account of a private that separated from the Army in December 1990.

After creating the "ghost" account, the finance clerk manipulated the pay system to show that the "ghost" soldier had deployed to southwest Asia, thereby becoming eligible for additional payments for hostile fire pay, foreign duty pay, and family separation pay. The pay system was further manipulated to have the pay for the fictitious soldier forwarded to financial institutions in Virginia and North Carolina where the finance clerk had accounts.

Following the bogus reactivation of the separated soldier, the finance clerk promoted the "ghost" soldier six ranks to a sergeant first class and had the pay electronically transmitted to the clerk's bank accounts at a credit union in Indianapolis, IN.

Actions are underway to freeze \$22,000 of assets which remain in the finance clerk's bank accounts. In addition, the Staff Judge Advocate Office has filed criminal charges against the clerk with preliminary hearings scheduled to begin later this month.

Example 2

In August 1992, a finance clerk manipulated the payroll system by establishing pay accounts for two fictitious soldiers. Over \$33,000 in payroll payments for these two "ghosts" were electronically submitted to the clerk's bank account in Germany. In a statement to investigators, the finance clerk claimed that the documents used to create these fictitious accounts were initially submitted to the finance office as a test of the improved internal controls in the newly implemented payroll system, and the clerk forgot to stop the test after the false accounts were established in the system and funds diverted to the finance clerk's bank account. However, the clerk's supervisor was not aware of any such test being performed by the finance clerk. The Staff Judge Advocate Office initiated proceedings for criminal prosecution charging the finance clerk with larceny and fraud.

Example 3

In December 1991, a finance clerk generated documents to establish a pay account for a "ghost" soldier using a fabricated name and social security number. Rather than manipulate the payroll system directly, the finance clerk signed the bogus documents as the authorizing official and submitted them for normal processing. This resulted in the establishment of the "ghost" soldier's pay account. The finance clerk directed a \$700 monthly allotment to his bank account in Georgia. However, the re-

mainder of the pay was being held at DFAS because the manipulated records showed the "ghost" soldier to be in southwest Asia.

In January 1993, the clerk increased the allotment to \$1,500 per month. Meanwhile, he falsified documents to release \$14,000 which had been held by DFAS. In addition, prior to receiving the \$14,000, the clerk falsified another document to authorize an \$8,000 advance against the "ghost" soldier's pay which was also sent to the clerk's bank account. Overall, the finance clerk received over \$71,000 in payroll payments.

The finance clerk was court martialed, sentenced to 6 months in confinement, and reduced in rank from a specialist to a private.

Example 4

A finance clerk obtained a list of separated soldiers from the payroll system and reactivated a former soldier's pay account with pay disbursements deposited directly to his account at a financial institution in New Hampshire. In addition, the clerk directed a \$750 monthly allotment to a relative in Florida.

The clerk further manipulated the pay system and placed the reestablished "ghost" account in a permanent change-of-station status. This action prevents the delivery of monthly leave and earnings statements—a primary DFAS internal control established to prevent payroll overpayments. Finally, he promoted the reactivated "ghost" soldier and extended his enlistment until 1997. Over \$8,600 was paid to the "ghost" account before pay was suspended.

In December 1993, the clerk was court martialed, reduced to a private, fined \$2,300, and received a bad conduct discharge. Debt collection efforts are under way at DFAS.

Example 5

In October 1991, a sergeant first class did not return to his unit after being assigned to a temporary work location. The soldier was known to be a deserter by his unit in December 1991. However, because the unit failed to report the desertion to the personnel office, the soldier continued to receive full pay through May 1993. Improper payments totalling over \$43,000 were deposited directly to a midwest bank. The soldier was apprehended in October 1993. In January 1994, the soldier received an other than honorable discharge. The case has been referred to the U.S. Attorney's office in Illinois.

Example 6

From July to November 1991, a reserve major served on active duty in response to Desert Shield/Desert Storm. However, DFAS continued to send electronic pay deposits to a northeastern financial institution through April 1993, resulting in approximately \$88,000 in overpayments. Since the official separation documents were not forwarded to DFAS, the soldier's pay continued until our audit surfaced the situation in April 1993.

After being contacted by DFAS officials, the officer agreed to repay the government, even though he had already spent the funds. Criminal prosecution is under consideration by the U.S. Attorney's office in New York.

Example 7

After a period of active duty, a sergeant major reservist separated from the Army in February 1992, yet continued to be paid through May 1993. Apparently, the soldier's official separation papers were not processed properly and the soldier's pay was continued. After separation, the reservist improperly received approximately \$46,000 in payments which were directly deposited to her bank account in a financial institution in Pennsylvania.

The U.S. Attorney's office in Pennsylvania declined criminal prosecution and DFAS is attempting to collect the debt.

Example 8

A reserve major entered active duty for 2 days during July 1991. After separation, the officer was not removed from the active payroll. The separated officer continued to receive pay through July 1993 when the overpayment was surfaced by our audit. During part of this period, he also collected reserve pay.

In addition, in November 1991, the officer received an additional pay transfer under a second social security number which DFAS officials are currently unable to explain. The officer's total debt is approximately \$149,000, plus penalties and interest.

CID investigated this case and is referring it to the U.S. Attorney's office.

Example 9

In July 1992 a reserve major separated from active duty service, yet continued to receive over \$51,000 in active duty pay through August 1993. During this 12 month period, the major also received pay for reserve drills. Facts pertaining to this case are still being developed, and the U.S. Attorney's office is considering criminal prosecution.

Example 10

A specialist separated from the Army in March 1991 and was entitled to separation pay of \$183.69 for accumulated leave. In June 1992, DFAS erroneously issued a final separation check of \$836,919.19, which according to DFAS officials was due to incorrect posting of entered data and lack of validation procedures prior to check issuance. From those funds, the former soldier invested \$300,000 in stocks and bonds, paid a relative's debts of \$200,000, placed \$100,000 in a savings account at a Missouri financial institution in order to purchase a house, and allegedly gave the rest to charitable organizations. The U.S. Attorney's office initially filed a civil complaint, however the individual attempted to conceal some of these assets before they could be recovered. Criminal charges are now pending.

ATTACHMENT II

DEPARTMENT OF DEFENSE'S IMPLEMENTATION OF THE CHIEF FINANCIAL OFFICERS ACT

The Chief Financial Officers Act of 1990 (P.L. 101-576) requires that a Chief Financial Officer (CFO) be established within the Department of Defense (DOD) to carry out the responsibilities and functions delineated by the statute. Also, the act stipulates that the financial operations of DOD's various revolving and trust funds, as well as DOD activities performing substantial commercial functions, be audited on an annual basis. The act further specifies that the Army and the Air Force participate in a pilot project requiring them to prepare and have audited their consolidated financial statements.¹

The financial audits which have been conducted pursuant to the CFO Act have provided overwhelming evidence of widespread and severe financial weaknesses requiring sharply increased emphasis and attention by DOD financial managers. The various audits have identified billions of dollars of erroneous disbursements, waste, mismanagement, misappropriation, fraud, and potential monetary benefits within DOD. In addition, the audits disclosed dozens of material internal control weaknesses and financial management systems deficiencies. These problems are so severe and prevalent within the Department that of the 35 financial statements audited during fiscal years 1991 and 1992, only 3—the Foreign Military Loan Liquidating Account, the DOD Military Retirement Trust Fund, and the National Security Education Trust Fund—received unqualified opinions. In fact, most of the financial statements have been deemed to be unauditable by the various audit organizations, clearly indicating that vast improvements and enhanced discipline are urgently needed in DOD's financial controls, systems, and operations.

The underlying themes arising from the various audits are the inability of many current systems to produce reliable and verifiable financial data, and the failure of personnel to follow established policies, procedures, and regulations. Many of the systems are the source of critical data for Office of Management and Budget and congressional considerations during budgetary preparations and deliberations. The required improvements in DOD's financial management systems, if properly implemented, will substantially fulfill one of the Act's primary objectives—improving systems of accounting, financial management, and internal control.

DOD's implementation of the CFO Act has begun to yield a number of positive benefits and results. The results and findings of the CFO Act-mandated audits provide one of the primary bases for initiating financial management improvements within DOD. The overall accuracy and reliability of some DOD organizations' financial records have improved, more reliable information is being made available for management and congressional decision-making, some improvements to financial systems and internal controls have resulted, and financial savings and budgetary benefits have been realized. However, for an entity as large and complex as DOD, the full realization of all potential benefits will require more than several years.

The CFO Act has also served to increase DOD top managers' interest in financial management. Senior DOD management officials have stated that the resolution of

¹The Army was required to prepare and have audited its fiscal years 1991 and 1992 financial statements while the Air Force was required to prepare and have audited its fiscal year 1992 financial statements.

financial management problems is now receiving high-level management attention. One military department, the Army, has achieved proactive, visible involvement from top management officials in resolving financial problems disclosed by the audits. Based on our discussions and briefings on the results of our fiscal year 1991 audit, the Army established a special action group directed by senior civilian and military managers to oversee implementation of corrective actions. However, in certain instances, DOD organizations have been slow to address serious deficiencies, thereby hampering effective financial management. For example, only in mid fiscal year 1993 did the Air Force and DFAS develop a financial management plan aimed at addressing deficiencies in the Air Force's financial systems and controls that we initially reported in February 1990.

FINANCIAL STATEMENTS ISSUED AND AUDIT RESULTS

Pursuant to the requirements of the CFO Act, DOD organizations prepared seven financial statements during fiscal year 1991 and 23 during fiscal year 1992. GAO and the DOD Inspector General (with the assistance of the military services' audit agencies) conducted financial audits of these 35 statements. The financial statements prepared and audited during fiscal year 1992 encompassed approximately 66 and 80 percent of the total assets and revenues (including appropriated funds) controlled by DOD. The largest DOD component not subject to audit under the CFO Act is the Navy. Should financial audit requirements be extended to include the Navy, audit coverage of DOD entities would approach 100 percent.

Additionally, while each statement was audited, some of the audits, for various reasons, only covered certain accounts or financial statement line items. The audits' findings resulted in the issuance of 21 disclaimers, 8 adverse opinions, 5 qualified opinions, and 3 unqualified opinions. This highlights the magnitude of the problems and indicates that improvements are urgently needed in DOD's financial controls, systems, and operations. The following table presents the type and number of opinions received within each of the military organizations by fiscal year.

Table 1: Summary of Types of Reports Issued as a Result of Financial Audits Performed Pursuant to the CFO Act

Opinion received ¹	DOD	Army	Air Force	Totals ²
Unqualified:				
Fiscal year 1991	0	0	0	0
Fiscal year 1992	3	0	0	3
Qualified:				
Fiscal year 1991	3	0	0	3
Fiscal year 1992	2	0	0	2
Adverse:				
Fiscal year 1991	2	0	0	2
Fiscal year 1992	6	0	0	6
Disclaimer:				
Fiscal year 1991	1	1	0	2
Fiscal year 1992	17	1	1	19

¹ An unqualified opinion states that the financial statements are presented fairly in conformity with generally accepted accounting principles (GAAP). A qualified opinion states that, except for the matter to which the qualification relates, the financial statements are fairly presented in conformity with GAAP. An adverse opinion states that the financial statements are not presented fairly in conformity with GAAP. A disclaimer of opinion states that the auditor does not express an opinion on the financial statements. A disclaimer of opinion is issued when the auditor has been unable to perform an audit of sufficient scope to enable the auditor to form an opinion on the financial statements.

² Thirty-seven opinions were issued on 35 financial statements audited because the Naval Audit Service in its audits of the Navy's Defense Business Operations Fund activities issued opinions on various accounts/line items rather than on the financial statements taken as a whole.

BENEFITS RESULTING FROM FINANCIAL AUDITS

As discussed in the following sections, actions taken by DOD entities as a result of findings from CFO Act-mandated audits have already produced various benefits, including enhanced information for decisionmakers, improved systems and controls, and realized and potential financial savings.

Actions to Improve Information for Management Decisionmaking

One primary role of financial management is to provide DOD managers—especially program managers—the financial information needed to better manage activities and programs on a day-to-day basis. DOD organizations, which are among the largest and most complex in the world, require the highest quality and most timely

information available in order to (1) operate efficiently, (2) effectively fulfill their missions, and (3) ultimately ensure that our national security interests are preserved. As a result of CFO Act-mandated audits, DOD has initiated actions to correct identified weaknesses in internal controls. Those weaknesses have forced managers to rely on inadequate, inaccurate, and incomplete information in making program and operating decisions. Following are examples of completed and ongoing improvements in the quality of information provided to decisionmakers.

- The Army established quality assurance processes to ensure that management information in its real property system is more accurate, thereby enhancing the reliability of future budget requests and avoiding performance of additional validation reviews of data required by the Defense Base Closure and Realignment Commission.
- DOD re-emphasized the need to conduct physical inventories, in order to (1) improve controls over materiel inventories at depots, (2) provide assurance that unnecessary purchases are avoided, and (3) to ensure that materiel issued is actually used and/or charged to the correct maintenance jobs. Further, the Army has actions underway to strengthen data input procedures to the system used to account for and control repairables to ensure maintenance work and cost is accurately recorded to individual jobs. In addition, the Defense Logistics Agency plans to implement an inventory program requiring physical inventories of items which have been requested but issuance denied due to item outages.
- An estimated \$18 billion in potential liabilities associated with hazardous waste disposals at Army installations were disclosed by CFO Act-mandated audits of the Department of the Army.
- The Corps of Engineers initiated a detailed analysis and reconciliation of its construction-in-progress account to purge completed projects and determine whether such projects were properly accounted for in the financial records. While completed projects have been removed from the construction-in-progress account as a result of this effort, many more remain, and the Corps continues to conduct this analysis and reconciliation on an annual basis.
- Approximately \$128 billion in adjustments were recorded to improve the accuracy of Army commands' financial records.

Actions to Strengthen Systems and Controls

DOD organizations have a long-standing history of widespread and serious control weaknesses within their financial management systems. Such weaknesses hamper efficient and effective management of operations. Audits conducted under the CFO Act during fiscal years 1991 and 1992 have led management to strengthen controls. Also, managers have been provided a better understanding of deficiencies for which they can implement corrective actions, thereby enhancing systems and controls. For example:

- The fiscal year 1991 audit of Army's financial operations found that billions of dollars of weapons and equipment awaiting repair and overhaul at maintenance depots were not adequately stored to prevent extensive corrosion which directly resulted in repair cost overruns. Since we reported the problem, DOD relocated these assets to more protective environments and Defense Logistics Agency personnel are now reviewing all storage decisions to ensure that expensive, fragile, and highly corrodible items are protected against the elements.
- Audits conducted at Army, Air Force, and Defense Finance and Accounting Service organizations highlighted the importance and necessity of solving the serious problem of unmatched disbursements. The audits prompted DOD to develop a plan to eliminate systemic causes which led to billion of dollars of unmatched disbursements and to establish a task force to research and resolve existing unmatched disbursements.
- Findings from the fiscal year 1992 Army financial audit prompted the Army's Criminal Investigation Command to conduct investigations of potential payroll improprieties. In addition, it was determined that the DFAS-Indianapolis Center's debt management system was not operating effectively and, as a result, approximately \$27.5 million of payroll debts resulting from employee separations were not included.
- Our audit of the Army's fiscal year 1992 financial statements revealed that accounting records documenting individual transactions posted by subordinate commands of the Army Materiel Command, which are necessary to support balances in the budget execution system, were not retained. According to Army officials, as of October 1, 1992, records for all transactions are being retained.
- As a result of our audits of Army's financial systems and operations, the Office of the Deputy Chief of Staff for Logistics informed us that actions were being initiated to improve the accuracy of data recorded in Army's central logistics

system for reporting the types, quantities, and locations of equipment. In addition, the system was included as a special interest item in the Command Logistics Review Program.

Realized and Potential Financial Savings

Making the most effective and efficient use of available resources is paramount in today's environment of constrained budgets. Audits conducted of the military services over the last several years have revealed that budgetary resources are not always adequately controlled and, at times, are inappropriately used. The audits have directly led to the recoupment of millions of dollars from contractors, as well as millions of dollars of potential budget reductions. In addition, further savings could be realized if DOD organizations and the military services complete actions necessary to strengthen internal controls and fully implement the act's requirements. Following are examples of both realized and potential financial savings resulting from CFO Act-mandated audits or financially-related audits.

- The DOD Inspector General has reported \$576.6 million of potential savings, \$35.4 million of recoveries, and \$200.8 million of resources used more efficiently as a direct result of CFO Act-mandated financial statement audits conducted by Defense audit organizations.
- Audits of the Army determined that overpayments had been made to the services' contractors who had returned \$751 million by the first half of fiscal year 1993.
- The Naval Audit Service reported that its audit of the Navy's fiscal year 1992 DBOF operations disclosed numerous deficiencies and areas of potential improvements, which if corrective actions were taken, could result in potential monetary benefits of almost \$3.3 billion. For example, the audit service identified potential budget reductions of \$30.7 million related to understated inventories (thereby causing requirements to be overstated) and more efficient use of \$78.3 million which could result from the disposal of excess stocks.
- The Army financial audits identified \$7.8 million in payroll payments made to unauthorized personnel. The Army has initiated efforts to collect these overpayments and as of March 1994, \$1.7 million had been successfully collected.

Data Provided to the Congress Not Reliable

The Congress requires financial and programmatic information from DOD organizations in order to assess mission performance and to make funding and other decisions affecting DOD programs and operations. These decisions are often based upon data derived from financial management systems, which are included in the scope of audits conducted pursuant to the CFO Act. Therefore, when such audits find information in these systems to be unreliable, it can be construed that reports and justification documents used in congressional oversight and decisionmaking will also be unreliable, thereby impairing the Congress' ability to make fully informed decisions. Following are examples of data provided to Congress in support of budgetary requests for which financial audits disclosed questions regarding the data's reliability:

- A CFO Act-mandated audit of the Army noted that fiscal year 1993 budget justification data was unreliable because information supporting the amounts requested for real property maintenance was developed from erroneous data in the real property systems.
- The reliability of data used to support DOD's budget requests for certain readiness-related activities is questionable. GAO's financial audits of the Army revealed that cost factors used to support the requests, such as flying hours (for aircraft) and square footage (for buildings and facilities), did not always include all relevant or accurate costs, such as administrative expenses and pilot salaries.
- The Defense Business Operations Fund, which annually generates approximately \$77 billion in revenues, is supposed to bill its customers—primarily the military services—for the full cost of goods and services provided, including administrative and operating expenses. Congress in turn appropriates funds to the military services to pay for these costs. Audits have found, and the then DOD Acting Comptroller acknowledged, that the Fund's current accounting systems are not adequate—they cannot provide complete and reliable financial data, including the cost of goods provided and services rendered. Therefore, the Fund cannot be assured that it is recouping all of its costs, or that it is charging its customers for only the costs incurred.
- Some weapon systems cost information provided to the Congress to support critical funding decisions is questionable. A CFO Act-mandated audit of the Army

found that cost data was incomplete and inconsistent for various weapon systems, such as Black Hawk helicopters.

COSTS OF PREPARING AND AUDITING DOD'S FINANCIAL STATEMENTS

Costs to prepare and audit DOD financial statements are significant; but the resulting benefits and improvements clearly show the investment to be worthwhile. According to the DOD Inspector General, DOD organizations spent \$2.9 million in preparing fiscal years 1991 and 1992 financial statements and the federal audit community expended approximately \$46.5 million auditing the statements. While the costs of financial statement preparation and the audits, are significant, the costs are relatively low given the size and volume of operations conducted by the entities being audited. To date, the costs of the audits, in most cases, have been less than one-hundredth of one percent of the total assets or total expenses reported in the entities' financial statements.

As the DOD audit organizations obtain more experience in performing financial audits and as the military services and DFAS obtain more experience in preparing financial statements, the associated costs should significantly decrease. In addition to the costs being small in comparison to the assets and expenses covered, they are greatly outweighed by the financial recoveries, potential recoveries, and benefits resulting from the audits discussed previously.

The DOD Inspector General, for example, has reported the recovery of millions of dollars as a result of the CFO Act-mandated audits conducted by his organization. In its *Semiannual Report to the Congress* (April 1, 1993 to September 30, 1993), the DOD Inspector General reported that fiscal year 1992 financial statement audits conducted by Defense audit organizations identified potential savings of \$576.6 million, recoveries of \$35.4 million, and better use of \$200.8 million in resources. These total monetary benefits were more than 30 times the cost of the audits.

DOD audit organizations performed most of the audits of DOD entities and, therefore, incurred the most substantial costs. The CFO Act requires that the financial statements of DOD's pilot agencies—the Army and Air Force—and its revolving and trust funds be audited by the Inspector General, an independent external auditor as determined by the Inspector General, or the Comptroller General. To help carry out its audit responsibilities, the DOD Inspector General designated individual services' audit organizations to perform some of the audits. The fiscal year 1992 financial audits of the Defense Business Operations Fund and the fiscal year 1991 audits of several other smaller revolving and trust funds, were performed by the DOD Inspector General, the Army Audit Agency, the Air Force Audit Agency, and the Navy Audit Service. In addition, the Air Force Audit Agency audited the Air Force's consolidated fiscal year 1992 financial statements, while GAO, with assistance from Army Audit Agency and Navy Audit Service, and DOD Inspector General audited the Army's fiscal years 1991 and 1992 financial statements.

The DOD audit agencies have been strongly committed to train their staff in conducting financial audits. Through 1993, over 600 DOD auditors had attended GAO's financial audit training classes. Other DOD auditors received on-the-job training by working with GAO on the Army financial audits. Army Audit Agency staff assisted GAO on the fiscal years 1991 and 1992 Army audits while DOD Inspector General and Naval Audit Service auditors worked on the 1991 audit.

Chairman GLENN. The next witness is Derek Vander Schaaf, Acting Inspector General, Department of Defense. Mr. Vander Schaaf, welcome again to our hearings and we look forward to your testimony. And if you will introduce your colleague there so we can have it for the record?

TESTIMONY OF DEREK J. VANDER SCHAAF, DEPUTY INSPECTOR GENERAL, DEPARTMENT OF DEFENSE; ACCOMPANIED BY ROBERT J. LIEBERMAN, ASSISTANT INSPECTOR GENERAL FOR AUDIT

Mr. VANDER SCHAAF. I have Mr. Robert Lieberman, who is the Assistant IG for Audit, with me this morning. He is most knowledgeable about these problems. He has worked on them for years and I am sure he will be of assistance in explaining them.

Chairman GLENN. Good; thank you.

Mr. VANDER SCHAAF. You have covered a lot of them already this morning. In my statement I talk about the various problems, some of which are easy to describe and understand, such as dealing with duplicate and overpayments to contractors, making payments to soldiers who are no longer in the Army, spending more than was appropriated and keeping inaccurate records.

Other matters which you have touched on this morning, such as not matching disbursements to obligations or not maintaining fund integrity during disbursement processes, are far more complex and more difficult to deal with. Some of the problems, such as the unmanageable situation created by having 161 different accounting systems, have been obvious for years. In fact, the creation of the Defense Finance and Accounting Service and the Corporate Information Management initiative was driven by the Department's realization that drastic reform measures were necessary.

Other problems were known within the DOD financial management community, but remained largely invisible to top DOD officials and Congress until the Department made its first attempts to construct auditable annual financial statements. The Comptroller General, the Auditor General of the Air Force and the Office of Inspector General described many of these problems to the Committee during hearings on July 1, 1993. We pointed out widespread internal control weaknesses; failure to reconcile existing data or maintain audit trails; significant instances of failure to comply with laws and regulations, ranging from the Prompt Payment Act to the Chief Financial Officers Act; the lack of standard data elements for financial systems or a standard general ledger; and the limited use of the DOD chart of accounts.

In that hearing, we noted that only two of the 16 1992 financial statements audited by our staff received relatively clean opinions, and the results of the other audit organizations' work were no more positive with respect to financial statements.

We have increased significantly our audit coverage of financial management matters in the Department of Defense in recent years. Despite budget cuts in audit resources and high demand for coverage in other program areas, the DOD internal audit community plans to commit about 500 work years and about \$40 million to chief financial officer type reviews in fiscal years 1994 and 1995. For the last 2 years and for the foreseeable future, implementing the CFO Act involves the largest commitment of auditors ever to a single purpose.

In addition, my office will continue the expanded operations audit coverage of financial and accounting matters that we began after the creation of the Defense Finance and Accounting Service. The results will be a continued, steady flow of audit quality information to DOD managers and Congress. Examples of recent audit reports are summarized in the attachment to my statement. The financial statement audit reports on fiscal year 1993 statements will not begin flowing in final form, at least, for several more weeks and we will issue most of those in June of this year.

In retrospect, it is unfortunate that the CFO Act and the revisions to the use of "M" accounts did not come into being long ago to focus DOD and Congressional attention on this vital aspect of the Department's operations. It also should be candidly stated that

the procedures requiring General Accounting Office certification of DOD accounting systems, the Federal Managers' Financial Integrity Act, the Antideficiency Act, numerous Federal and DOD financial management improvement programs, and millions of dollars spent on financial systems, all failed to keep the kinds of problems now being highlighted from developing. Likewise, in hindsight, there was clearly insufficient and poorly focused and coordinated audit coverage.

Now, the causes, as I see them are as follows: the first was allowing the proliferation of incompatible, parochial systems and non-standard elements, as we have mentioned. Other prominent causes for current financial problems include the wave of fixed-price weapons system development contracts that took place in the early and mid-1980's. That ill-fated experiment gave rise to a long list of troubled acquisition programs whose escape valve, the merged surplus accounts, was rightfully closed by the Congress because of an additional series of miscalculations in the form of inappropriate use of those "M" accounts by the United States Air Force.

When an agency faces painful downsizing decisions and has numerous financially strapped programs, it urgently needs responsive, accurate and reliable data on costs and fund availability. Unfortunately, it is precisely at this critical juncture for the Nation's defense that the DOD and Congress have both recognized the serious shortcomings of DOD fiscal systems, records and reports.

As the new DOD Comptroller is fond of saying, we need to change a tire while going 60 miles per hour and there is no way to stop to do it, because funds need to keep flowing to tens of thousands of suppliers and millions of active and retired military members and civilian employees.

At the same time, it would be a mistake to give in to gloom and doom. While the difficulties in fixing huge problems like the poor interface of DOD contract management and accounting systems should not be underestimated, I am dubious about claims that corrective action needs to take many years.

Now, what needs to be done? We believe the following things are crucial. One, we have to have top management involvement in this process. For the first time, at least in my 30 years associated with the Defense Department, we have created a Senior Financial Management Council and it really appears to be "senior". I have attended maybe half a dozen or more meetings in the last 6 months to a year. The Service Secretaries, the Vice Chairman of the Joint Chiefs of Staff and people of that level are regular attendees and are now having to take an interest in this business of accounting and finance and financial management controls in the Department of Defense. That is unique. The problem has been a tendency to over-focus, if you will, on next year's budget and resource allocations and not on paying attention to program execution. So top management involvement is critical.

Second, Congressional interest. Periodic hearings of the kind you are conducting here today are important to demonstrate Congressional interest and to provide a forum for discussion of DOD programs. Your leadership in this regard is very helpful, Mr. Chairman.

Three, restoration of Antideficiency Act credibility. The process which we go through in the Department of Defense to determine who or what was responsible for causing us to have a violation of the Federal Antideficiency Act is atrocious. The new Comptroller in the Department has recognized this and we are taking some steps to handle this process in a much expedited way. We are giving due consideration to using people who will become proficient at conducting Antideficiency Act violations, so that hopefully we can get at some of this problem you discussed this morning of who is responsible for some of these activities so we can hold people accountable.

The fourth thing I would emphasize to you in terms of corrective action is close monitoring of automated system development efforts. We have spent literally hundreds of millions of dollars trying to develop new automated systems in the Department of Defense for our financial management processes alone. Those development processes have taken too long. They cost too much and they don't result in systems that satisfy user needs. They tend to satisfy unique program or sub-organizational needs within the Department and they don't really satisfy overall departmental needs.

The fifth thing I would do is reexamine on your part some budget and accounting data requirements that you, the Congress, put on the Department of Defense. I am quite certain that 2-year budgets would be helpful, as well as longer periods of availability for obligations. Fewer appropriations or less restrictions on specific line items also might be helpful, and the elimination of unnecessary budget exhibits and reports are possibilities to help management in this area.

The sixth thing I would do is make sure we get some improvements made on the Defense Business Operations Fund, and that has been addressed to some degree today. I am a bit of a skeptic about the DBOF and the processes related to it. Frankly, we are going to spend an awful lot of money on cost accounting and DBOF rate-setting. That may be necessary if we are going to continue to use DBOF, but until we make good data available to organizations in DOD that provide DBOF services and until the people who have to purchase DBOF services have an opportunity to purchase those services from other customers, to me, the kinds of savings we are likely to achieve with DBOF are at the margin and I am not as totally convinced as some are that this is the way to go.

But we have looked at the process that went on last fall, as I believe was mentioned in earlier testimony, to make some improvements in the program and, for now, we are on board with trying to fix up the DBOF system and get it in a position where it will be useful and effective in managing the Defense Department.

I believe that concludes the remarks that I feel are necessary. I want you to also consider that there is going to continue to be some bad news before it gets better in this area. I don't think it has to be bad news for another 5 years, but I think you are going to see another 2 or 3 years of bad news until these financial systems are brought up to snuff and the Department can issue financial statements that are credible and auditable.

Thank you very much, Mr. Chairman.

Chairman GLENN. Thank you very much, Mr. Vander Schaaf. I have here your audit reports from over there. I have six of them here that we have been through here.

Mr. VANDER SCHAAF. Those are relatively new ones.

Chairman GLENN. They are on specifics here and I wanted to follow up by asking a few questions on these things. I recommend these to people who are interested in this particular subject.

Under the subject of debt cancelation, you issued a disturbing report earlier this year that documented DOD errors in canceling debts relating to the Persian Gulf conflict. The law was very clear. Congress authorized DOD to cancel any part of a debt up to \$2,500 that was incurred by a service man or woman in connection with Desert Shield and Desert Storm.

You found that one-third of the debts canceled by DFAS did not meet the legal requirements. In fact, some of the debts represented fines, forfeitures, overpayments. Your report indicates that \$15 million of the \$20 million in debts canceled by one DFAS center were not authorized. That is a 75-percent error rate. Is nobody paying any attention to the law at those centers?

Mr. VANDER SCHAAF. Well, they didn't write good programs to allow them to cancel that debt in a well controlled way. The persons that wrote the programs either didn't pay any attention to the law or were unable to test the automated programs that led to the poor result. We have now recommended, and strongly recommended, that DFAS go back and try to re-collect some of that money.

So far, we have received non-concurrences from the DFAS people on doing that. I think there is some fear on their part that they will go through another period where the people who are asked—hey, we canceled your debt, we made a mistake in canceling, you owe the Government this money—go back to their Congressional representatives with complaints. There is a lot of further recrimination in that kind of thing and the DFAS people don't want to mess with it. We believe that, if debt above \$250 was wrongfully forgiven, we should put it back on the books and try to at least make a reasonable effort to collect it.

Chairman GLENN. Now, we are talking \$15, \$20 million there, 15 out of the 20. If you get over into undistributed disbursements, which is another one I wanted to get into, we are talking money here now that gets up around \$35 billion of undistributed disbursements, \$9 billion of which represented payments made more than 180 days earlier. These, as I understand them, are payments that have been made that haven't been put back into the accounting system yet to make sure that we have them in the proper spot for balances to be run and things like that. Is that correct?

Mr. VANDER SCHAAF. That is correct, but—

Chairman GLENN. Were any of these, do you think, unauthorized payments or payments that should not have been made at all?

Mr. VANDER SCHAAF. A certain portion might be. I heartily endorse what was said earlier during the GAO testimony on this matter. We should have a system that ensures we do not make a payment until we are sure that we have a legal and appropriate obligation on the books, and the payment then liquidates that obligation.

Currently, our systems are such that, when we write a check at one place and it is liquidating the obligation that is on the books and records of another organization or place, we simply are often unable to maintain control. Remember, there is a lot of pressure on the Department to make those payments in a prompt way. There is something called the Prompt Payment Act, and for good reason, because our suppliers are entitled to reasonably prompt payments. Those systems have broken down, so people will short-cut the systems, make the payments anyway and, of course, that leads to potential fraud.

Chairman GLENN. Now, \$35 billion in undistributed disbursements, and your reports States, as large as those numbers may be, that DOD may have underreported that by at least \$7 billion that was outstanding for more than 180 days. Is that correct?

Mr. VANDER SCHAAF. Yes, I believe that is correct. I will get Mr. Lieberman to get in here a little bit on this as well. The undistributed number, like I say, is bothersome, but there you are looking at a situation where we have a lag time. What is really more bothersome is the smaller unmatched disbursements where we have attempted to make the distribution, if you will, and were unable to make it. In the first place, we haven't even attempted to do it because we just didn't have the time and wrote the checks.

Bob, do you want to make some addition on that?

Mr. LIEBERMAN. Well, the \$7 billion is a subset of the 35, Mr. Chairman.

Chairman GLENN. It is part of that 35?

Mr. LIEBERMAN. Yes. It is the oldest part of the 35.

Chairman GLENN. OK. That is the part that would be outstanding for over 180 days, then, right?

Mr. LIEBERMAN. Yes.

Chairman GLENN. OK. We talked earlier in the hearing about \$751 million returned to DOD by contractors primarily because of overpayments. Last month, you issued a report that shed light on why these overpayments occurred and why it was that the contractors, not DOD, discovered the overpayments. DOD apparently relies on contract reconciliation to uncover payment errors, but DOD has at least 6,600 known problem contracts that haven't yet been reconciled. I understand that it may take DFAS as long as 3 years to clear that backlog.

Do you have any estimate at all of how many overpayments might have been made in those 6,600 or what the estimate would be if you just take the same percentage of overpayment we have had in the past? Do you have any figure of what that might represent?

Mr. VANDER SCHAAF. No, we don't. Those overpayments are a portion of the \$751 million that came back. We just don't have a way to make an estimate on that. The GAO is in the process of doing a detailed review, as they mentioned in the previous panel, and hopefully after they get their review done, they will be able to answer your question. I just can't answer your question right now.

Chairman GLENN. The 6,600—do you think it well may be the 26,000 that GAO testified to?

Mr. VANDER SCHAAF. Well, the 6,600 figure may have come from an audit report, one of those you showed there before you, and that

was the low-range estimate of how many of a sample of 16,742 contracts had one or more errors in their accounting data. The data were so poor we couldn't do a point estimate. That was the low-range estimate. The high-range estimate, I believe, was 12,408. The errors may show overpayments or payments that are unreconciled.

Mr. LIEBERMAN. And that was as of January 1993. We don't know what the current numbers are.

Chairman GLENN. Just one more question, what I ended the last session on with the previous panel. Do you see CIM, the Computer Information Management system, being critical to really getting good control of financial management in the Pentagon? Is it as critical as some feel or have made it out to be, or is it just going to be sort of auxiliary tool?

Mr. VANDER SCHAAF. Well, it is critical. The process of putting systems together, making uniform data elements, finding the best system—that is critical. One good step in that direction that just was taken recently is they have put the Assistant Secretary of Defense for Command, Control, Communications and Intelligence, who is the individual responsible for the CIM, on the senior financial management steering group in the Department. I think that was a very credible thing to do because many of the things that need fixing are, of course, related to the CIM process.

Chairman GLENN. Just one related to that and then I will end. The CIM security—you mentioned that in your statement.

Mr. VANDER SCHAAF. Oh, yes.

Chairman GLENN. How are we going to handle that one, or can we?

Mr. VANDER SCHAAF. Well, we have a big problem with security. We issued four audit reports with respect to security in the finance and accounting centers with their programs. We found some very serious weaknesses, not so much within the accounting centers themselves, but within the agency that does the systems design for the finance and accounting centers.

Chairman GLENN. Unless we have that built in, fraud and abuse and embezzlement just stays easy.

Mr. VANDER SCHAAF. That is right. We have issued public reports on these matters, but we have issued very private reports to the people involved to show exactly how we were able to find where the weaknesses are in those systems. If you can get into the systems, you can create new pay records or you can get rid of old pay records. You can do certain things and never leave an audit trail showing that you were into the system, and that is a very serious problem and it has got to be dealt with immediately.

Chairman GLENN. My time is up.

Senator Dorgan?

Senator DORGAN. Mr. Vander Schaaf, I recall a few years ago where the Washington Post had on the same day two stories, one about a Defense contractor pleading guilty to a felony in Federal court in Alexandria in a plea bargain arrangement with the prosecutors, and on the same day in the Pentagon an announcement about the new contract they had just signed with the same contractor. These stories seemed to me to be the ultimate irony.

In 1985, I offered an amendment that became law that prohibited convicted felons from being employed by Defense contractors, essentially, and require that an apparatus be developed so that we are certain that they aren't. Then in 1992, I offered an amendment, which is also now law, which requires a compilation of the list of those who have been convicted of committing felonies while working for Defense contractors so that that list would be available.

I had written you in October of 1992, and in one of your responses back then you did not agree, and also I believe actually this is the Defense procurement reform proposal.

Mr. VANDER SCHAAF. It is the Section 800 group.

Senator DORGAN. Yes. That proposal would essentially drop out the second provision that I have talked about because you indicated you did not concur with that. Can you tell what your current thinking is about that area?

Mr. VANDER SCHAAF. Well, I don't recall that 1992 correspondence exactly, but let me tell you what I think my concern was at that point. We are attempting to buy more products under commercial specs, commercial practices and procedures in the Defense Department, and our office is very supportive of the Department's effort to move in that direction. We think there are a lot of opportunities for savings and to improve procurement processes, and so forth.

In doing that, it is very difficult for a contractor who is a commercial contractor to be able to certify that no one who works for them has ever been convicted of felonies involving Defense work. We felt, if I recall correctly, that the detrimental effect of many commercial suppliers being unwilling to get involved and sell to the Government, because they might unknowingly have someone with a criminal record on their payroll, was just not worth the effort.

We will still have a suspension and debarment process in the Department on Defense, but not for these commercially awarded contracts. I think that is what we are talking about.

Senator DORGAN. But in the procurement reform bill, you do not concur with generally the requirement of the listing. I understand from your answer why you think there is a different way. You don't, I assume, disagree with the 1985 amendment that is now law that really says, look, if somebody has committed a felony against us, they ought not be hirable by another Defense contractor.

Mr. VANDER SCHAAF. But if they are not a Defense contractor, if they are a commercial contractor, then it is very difficult to enforce that across the board. When a commercial contractor decides they want to sell to the Department of Defense, you don't want to have to exclude them from selling anything to the Department of Defense under any circumstances because they previously hired an individual who had defrauded the Defense Department years before joining the commercial firm.

Now, with our major contractors, with those suspension and debarment processes, we go through a coordination of remedies process and we will require, for example, that they dismiss or move out of the Defense sector of their business employees who are implicated in defrauding the Defense Department.

Senator DORGAN. But the major Defense contractors themselves have been guilty of defrauding the Defense Department and signed new contracts with the Defense Department the same day that they have a plea bargain.

Mr. VANDER SCHAAF. Yes, but there is a process for suspension and debarment. It is difficult to suspend or debar an entire major contractor firm, but we have suspended and debarred segments of large firms from doing business with the Department.

Senator DORGAN. But the incentive is not to do that because they have an investment in an ongoing contract and they possess the particular and peculiar skills to continue that project.

Mr. VANDER SCHAAF. I understand.

Senator DORGAN. Isn't that the case?

Mr. VANDER SCHAAF. It is a difficult problem to deal with, but the Department has dealt with it relatively well in the last decade. When I started in this business, the DOD suspended and debarred only a handful of contractors and individuals annually. I think we peaked at about 1,200 a year, and I don't know what we have done already this year, but there are several hundred annually that we report in our 6-month semi-annual reports to Congress. I am not arguing with you about what we should do. It is just that when you try to apply this to a strictly commercial environment, it is more difficult.

Senator DORGAN. Well, let me go back to the other question briefly, the question of ghost employees, the question of payments for which there is not any matching of services or products provided. Unless we hold accountable those who are in charge of these processes that have failed, do you think that in 3 or 5 years we will have another hearing in which a report is issued by GAO or someone else that says, you know, all of these problems disappeared now; it is true, we have got some of the same people running them, but they just have been reeducated on how to set up an internal security system and everything is just fine?

Mr. VANDER SCHAAF. Well, I think in a system as large as ours there will always be some problems and there will always be somebody trying to defraud the system. That is not really the thing that worries me. It is, as Chairman Glenn indicated, the billions of dollars of unmatched payments and systems that are bad and systems that lack controls.

Should we hold people accountable? Absolutely. That is why we have been pressing the Department to do something about Antideficiency Act violations. We issued a report back in early 1992 which showed how poorly that process was being handled. When you willfully incur a deficiency in an appropriation, under existing law there are criminal penalties. We believe people ought to be held accountable criminally or administratively, as the facts warrant. I have some concerns about the practicality of the criminal sanctions, because we haven't been able to use them, but their existence slows the process down. Currently the systems sometimes are so weak and there are so many people involved in the process that it is very difficult to say which individual is the culpable person, but we can do a lot better in that area.

Senator DORGAN. Are you aware of any significant effort to identify people and say, look, you have just blown it here and we are

going to reassign you; you are losing your job? Isn't it more likely the case that an audit is done and somebody says, oops, yes, we don't have internal controls to prevent ghost employees, et cetera? And so, OK, now what we do is get a new book, a new procedure, and now we have got internal controls, but the same people are running the place. Isn't that more likely the case?

Mr. VANDER SCHAAF. That is the more likely case, yes.

Senator DORGAN. The reason I ask that is I think that also will prevent us from hearing better news in the future. We have got to have some accountability for who is running these systems and who is in charge of making sure we comply with them. Most of the things we have talked about today are not because people don't know how to relate a payment to a service or a product. It is because some place along the line the system broke down and somebody said, we don't have to do that, let us send them the check.

Mr. VANDER SCHAAF. Let me give you an example of some place where it breaks down, and I think you have to give these people some credit. They are under a lot of pressure and they are being pulled and pushed in different ways. The Prompt Payment Act, for example, says you must pay an invoice within 30 days. After you get an invoice, unless you can show it is not legitimate, you must pay it. The system is so bad that the finance personnel often can't make the proper match to a contract line item or the detail to the obligation. They have a valid DD 250, a delivery of service, in their hands with an invoice attached to it. Everything seems to be in order.

Historically, the vast bulk of those are in order. The finance people are pressured from the Prompt Payment Act. Somebody says, let us write the check and let us get on with it, we will figure out why we can't seem to find the obligation that this transaction should liquidate later, and they do that. The Department has let the backlog of transactions grow for too long, and now they have to catch up and fix that situation.

But it is very hard in that kind of a circumstance—I don't want to make a scapegoat of the GS-5 accounting clerk who made decisions like that, working within a policy guidelines of the organization. The Department has to pay its bills—that person is not responsible for the failings of the accounting systems. It is further up the line where somebody has to be held responsible, and systems-wide. I get what you are saying. It is just not as easy, though, as you seem to express it might be.

Senator DORGAN. Well, Mr. Chairman, my time is up, but I do want to just make a comment on this last point. The next witness, Mr. Hamre, is going to say that he is blunt in his testimony, but he is also going to say that he doesn't want that to reflect unfairly on thousands of people who do a good job in this area. I understand why he says that, but I am telling you, you can't be too harsh on a system in which I get an invoice today and bill the Defense Department for some fire hose for a decommissioned ship and get payment 3 weeks from now.

Somebody some place isn't thinking. It is pretty hard to be too harsh in your criticism of that sort of thing. I mean, it is an example of what Mr. McGill did easily without even breaking a sweat,

taking several million dollars for just sending billings to the Federal Government.

So I understand this is a big system. I worked for a Defense contractor, a very large aerospace firm. We were involved with NASA and DOD. I understand these are very big systems, but when you get to the basics, how are people paid when they are not performing—you know, ghost employees—and how does Mr. McGill send us \$3 million of bills and get paid, that is not complex. That is just fundamental failure of a system.

Mr. VANDER SCHAAF. Absolutely. I agree completely on that, and there may be some reason to pass some of that responsibility up the line to some people more senior. Senator Grassley made some comments along that line and I certainly don't walk away from his comments there. He even got down to names of individuals. I am not going to get into individuals, but I think there have been times where we could have, in that finance and accounting business, held people a bit more accountable.

Mr. LIEBERMAN. Senator, I can give you a success story along those lines if you would like to hear something different. Two years ago, the Defense Commissary Agency had a horrendous bill-paying problem. They had an enormous backlog of unpaid bills and small businesses were literally failing throughout the country because they couldn't get paid for selling groceries and produce to the Commissary Agency. On the other hand, when the Agency did pay bills they had a huge duplicate payment problem because, again, they weren't matching invoices and delivery vouchers properly.

The director of the agency was changed. The headquarters and the regional offices were reorganized. Several civil service people were removed from their positions or demoted, and I can tell you right now that the situation has turned 180 degrees and they have licked their prompt payment problem and their duplicate payment problem. So it is possible.

Mr. VANDER SCHAAF. But what happened took a lot of pressure from our office, half a dozen to a dozen detailed audit reports, before we finally made believers out of them that they had to do something. They did get with it.

Mr. LIEBERMAN. And three Congressional hearings.

Mr. VANDER SCHAAF. Right.

Senator DORGAN. Thank you.

Chairman GLENN. Thank you very much. On the other side, too, I have heard Mr. Hamre, who will be our next witness here, say before that some of the people who are out there doing some of the check-writing, and so on, are still doing it by longhand, writing the checks out, because we haven't provided adequate means to do this on a more modern basis. So they are still sitting out there with pen and ink writing out some of these hundreds and hundreds of thousands of checks.

Mr. VANDER SCHAAF. Senator Glenn, may I add one other aspect to this? You are going to hear later on from the next witness, I am sure, a clear recognition that we have a problem, and there has been more open attitude than I have seen in a long, long time in the Defense Department about the problems.

However, last month the Department submitted a Federal Managers' Financial Integrity Act assurance letter, and said that we

can provide reasonable assurance that our systems are in control, et cetera. I disagreed with that, and I made my position known in the Department.

Management eventually decided to claim that reasonable assurance exists, but I still believe that we have a dichotomy on our hands. When it comes to a formal process like documenting and saying that we can't provide reasonable assurance—we are unwilling to stand up and so state—you look at that law and you have to do four things, it seems to me, to provide financial assurance that your internal controls are adequate, and so forth.

One, you have to show that obligations and expenditures are in accordance with applicable laws. I think the Department can maybe marginally pass that test, that one of four. The second thing you are supposed to show is that funds, property and other assets are safeguarded against waste, loss or unauthorized use or misappropriation. Frankly, based on these hearings and all kinds of work we do, I don't think they can pass that test with respect to DOD financial management systems.

The third thing you should do is make sure your revenues and expenditures are properly recorded and permit the presentation of reliable financial statements. Well, I know for a fact, I am 100 percent sure, we can't pass that test except for two funds—one of them happens to be a large fund, but both are easy to keep track of—we were not able to render favorable audit opinions on the 16 financial statements we audited.

The fourth thing you have to be able to do is ensure the agency's accounting systems conform to the Comptroller General's accounting principles and standards. Well, we can't pass that test either. But in lieu of submitting a statement that said we are not in compliance with the Federal Managers' Financial Integrity Act, the Department concluded that, since it can provide overall assurance that it can accomplish its mission, its internal control systems are accomplishing their purpose, although we do in the details show a lot of internal control weaknesses. I wanted to bring that point out here, too, because I think that is relevant to this hearing.

Chairman GLENN. Thank you very much. We appreciate both of you being here. We are going to have to move along. We may have additional questions for you after we have reviewed the record. Other people may have additional questions and we would appreciate your response. Thank you very much.

PREPARED STATEMENT OF MR. DEREK J. VANDER SCHAAF

Mr. Chairman and Members of the Committee:

I am pleased to be here this morning to discuss financial management in the Department of Defense. I am accompanied by Mr. Robert Lieberman, the Assistant Inspector General for Auditing.

The Problems

For approximately 4 years, dozens of reports from my office, the GAO, Military Department auditors, congressional committees and the press have revealed a wide range of DOD financial management problems. Some are easy to describe—duplicate and overpayments to contractors, payments to soldiers no longer in the Army, spending more than was appropriated, and keeping inaccurate records. Others are more complicated—not matching disbursements to obligations or not maintaining fund integrity during the disbursement process.

Some of the problems, such as the unmanageable situation created by having 161 different accounting systems, have been obvious for years. In fact, the creation of

the Defense Finance and Accounting Service and the Corporate Information Management initiative was driven by the Department's realization that drastic reform measures were necessary. Other problems were known within the DOD financial management community, but remained largely invisible to top DOD officials and the Congress until the Department made its first attempts to construct auditable annual financial statements. The Comptroller General, the Auditor General of the Air Force, and the Office of the Inspector General described many of those problems to the Committee during the hearing on July 1, 1993. We pointed out widespread internal control weaknesses, failure to reconcile conflicting data or maintain audit trails, significant instances of failure to comply with laws and regulations ranging from the Prompt Payment Act to the Chief Financial Officers Act, the lack of standard data elements for financial systems or a standard general ledger, and the limited use of the DOD chart of accounts. We noted that only two of the sixteen 1992 financial statements audited by our staff received relatively clean opinions and the results of the other audit organizations' work were similar.

Audit Coverage of Financial Matters

In accordance with the CFO Act, another series of financial statement audits is under way. This is necessarily another huge effort, because financial statement audits are very labor intensive when large, complicated funds and voluminous, scattered and conflicting records are involved. Despite budgeted cuts in audit resources and high demand for coverage in other program areas, the DOD internal audit community plans to commit about 500 work years and over \$40 million annually to CFO reviews in fiscal year 1994 and fiscal year 1995. For the last 2 years and for the foreseeable future, implementing the CFO Act involves the largest commitment of auditors ever to a single purpose. In addition, my office will continue the expanded operations audit coverage of financial and accounting matters that we began after the creation of the Defense Finance and Accounting Service. The result will be a continued steady flow of audit quality information to DOD managers and Congress. Examples of recent audit reports are summarized in the attachment to this statement. The financial statement audit reports on fiscal year 1993 statements will not begin flowing, in final form at least, for several more weeks and most will be issued in June.

On the one hand, increased audit emphasis will ensure that the financial management problem areas are fully identified and the effect of corrective actions is closely monitored. On the other hand, the flow of reports on DOD financial management will strike many people as a drumbeat of criticism meaning that the problems are new or getting worse. In fact, in most cases, the financial management problems facing the DOD today have been festering for many years and blame for the proliferation of inefficient systems is shared by scores of officials over decades. In retrospect, it is unfortunate that the CFO Act and the revisions to the use of "M" accounts did not come into being long ago to focus DOD and congressional attention on this vital aspect of the Department's operations. It also should be candidly stated that the procedures requiring General Accounting Office certification of DOD accounting systems, the Federal Managers' Financial Integrity Act, the Antideficiency Act, numerous Federal and DOD financial management improvement programs, and millions of dollars spent on financial systems all failed to keep the kinds of problems now being highlighted from developing. Likewise, in hindsight there was clearly insufficient and poorly focused audit coverage.

The Causes

The Department must now face the music and live with the results of numerous previous bad decisions and poor management practices. Allowing the proliferation of incompatible, parochial systems and nonstandard data elements has been mentioned. Other prominent causes for current financial problems include the wave of fixed price weapons development contracts in the early and mid-1980's. That ill-fated experiment gave rise to a long list of troubled acquisition programs whose escape valve—the merged surplus accounts—was rightfully closed by the Congress because of an additional series of miscalculations in the form of inappropriate uses of those "M" accounts by the Air Force.

When an agency faces painful downsizing decisions and has numerous financially strapped programs, it urgently needs responsive, accurate and reliable data on costs and fund availability. Unfortunately, it is precisely at this critical juncture for National Defense that the DOD and Congress have both recognized the serious shortcomings of DOD fiscal systems, records and reports. As the new DOD Comptroller is fond of saying, we need to change a tire while going 60 miles per hour and there is no way to stop to do it, because funds need to keep flowing to tens of thousands of suppliers and millions of active and retired military members and civilian em-

ployees. At the same time, it would be a mistake to give in to gloom and doom. While the difficulties in fixing huge problems like the poor interface of DOD contract management and accounting systems should not be underestimated, I am dubious about claims that corrective action needs to take many years if the will exists to take on those problems once and for all.

What Needs to be Done

The crucial question, as we see it, is what can be done to ensure the DOD truly gets on top of its financial management problems and regains credibility that it can keep its books accurately. We believe the following things are crucial:

—Top management involvement. So far, the new DOD Senior Financial Management Oversight Council looks promising as a way to involve the most senior OSD and Military Department officials in systemic financial management issues. In previous years, those officials would have left problems like undistributed disbursements to the comptroller community to worry about in isolation, while also defending the need for unique accounting, finance and acquisition management systems in each Service.

As far as financial management was concerned, top managers tended to focus primarily on budgets and resource allocation decisions, not on accounting systems, execution, and program results. The historic pattern will continue unless there is leadership from the Office of the Secretary of Defense. The operations of the Senior Financial Management Oversight Council are demonstrating that such leadership is being provided and we certainly endorse its continuance. It is especially important that the Council follow up on all of the measures it directs, requiring meaningful progress reports and taking decisive action when progress lags.

—Congressional interest. Periodic hearings are important to demonstrate congressional interest and to provide a forum for discussion of DOD progress. Your Committee's leadership has been very helpful in this regard. Improving DOD financial management is an area where Executive Branch and congressional interests match very closely. There is clearly a consensus that the time has come for constructive change.

—Restoration of Antideficiency Act credibility. The Senior Financial Management Council has directed that measures be taken to improve the process for investigating apparent Antideficiency Act violations, promptly reporting results, and ensuring that more meaningful and consistent penalties are imposed when appropriate. My office is participating in the development of a more structured and effective DOD process, which in turn should help create more credible deterrence. We have been especially pleased by the recent action of the DOD Comptroller to pull the function of monitoring violation investigation status out of the Defense Finance and Accounting Service into his immediate staff. Likewise, we strongly endorse the excellent guidance recently issued by Mr. Hamre regarding the need to cease further expenditures as soon as there are indications of deficient conditions in any account.

—Close monitoring of automated system development efforts. All aspects of DOD finance and accounting operations necessarily are heavily computerized. Moving forward to standard, modernized systems is crucial if most of the problems are to be addressed effectively. The history of automated system development projects in the DOD, as in most of the Federal Government, is not an especially happy story. Development efforts generally take too long, cost too much, and do not result in systems that are fully satisfactory to the users. We simply must improve on that record. Frequent, meaningful progress assessments are needed. The GAO has considerable expertise in monitoring system development and I intend for my staff and the Military Department auditors to help as well. Besides monitoring progress in the system development area, there is a compelling need for audits of controls in existing systems that the Department will continue to depend on. As shown in the attached summaries, we have begun tackling that workload.

—Reexamination of budget and accounting data requirements. Congress could consider ways to help DOD simplify and streamline its account structure and financial management process. Two year budgets, longer periods of appropriation availability for obligations, fewer appropriations or less restrictions on specific line items, and elimination of unnecessary budget exhibits and reports are all possibilities.

—Improvement of Defense Business Operations Fund (DBOF) management. The DBOF is a bold attempt by the DOD to drive down long term costs. We support the DBOF concept and believe that the ongoing improvement plan directed by the DBOF Corporate Board is comprehensive and promising. That being said, it is true that the DBOF will yield very few if any benefits until (1) DOD cost accounting and DBOF rate setting improve and (2) more alternative sources of goods and services are opened to current DBOF customers. It is also imperative that DOD solve the cash management problems that plagued DBOF and aroused understandable con-

gressional ire over the past couple years. In general, we agree with the GAO assessment that progress is being made, especially now that the fundamental problem of the lack of specific, written DBOF management policies has finally been addressed.

In closing, we believe that the DOD has made a credible start in solving its numerous, deeply rooted financial system problems. By the same token, it is evident that much additional effort will be necessary. This concludes my statement and we would be happy to answer any questions.

ATTACHMENT

RECENT SIGNIFICANT INSPECTOR GENERAL, DOD, AUDIT REPORTS

FUNDING SHORTFALLS AND ERRORS IN NAVY ACCOUNTS

Report No. 94-036, "Financial Status of Navy Expired Year Appropriations," February 10, 1994. The audit reported potential Antideficiency Act violations in the MK-50 Torpedo and Standard Missile programs and potential funding deficiencies in the Trident II and Phoenix Missile programs, all of which are funded in the Navy Weapons Procurement appropriation. Also, potential deficiencies were found in the Navy Aircraft Procurement and Research, Development, Test and Evaluation appropriations. The official accounting records did not reflect the true appropriations balances, and the Navy had \$1 billion in net unmatched disbursements. We recommended that the Assistant Secretary of the Navy (Financial Management) investigate apparent appropriation account deficiencies for the MK-50, the Standard Missile, and the Phoenix Missile, fix responsibility, and report any actual Antideficiency Act violations; record obligations even if they may cause deficiencies; establish procedures for identifying requirements that may cause deficiencies in the future; maintain contingent liabilities in accounting records after funds expire; and properly record obligations supporting contingent liabilities. The report also recommended that the Navy correct obligational adjustments, post them to the correct fiscal year, and establish procedures to verify that administering offices obtain proper approvals for obligational adjustments within established thresholds. Further, the report recommended that the Director, Defense Finance and Accounting Service establish automated procedures for ensuring that correct funding information is entered into the Standard Accounting and Reporting System. Management concurred with all recommendations in the draft report except that the Navy Director of Budget and Reports did not concur with our recommendations to maintain contingent liabilities in accounting records after funds expire and to correct accounting entries to show the proper charges for contract modifications. Further comments were requested.

FUNDING SHORTFALLS AND ERRORS IN AIR FORCE ACCOUNTS

Report No. 94-062, "Financial Status of Air Force Expired Year Appropriations," March 18, 1994. The expired year Air Force Research, Development, Test, and Evaluation (RDT&E) and Aircraft Procurement appropriations had shortfalls, accounting problems, and potential violations of the Antideficiency Act. Four of the eight expired appropriations were experiencing financial difficulty. The fiscal year 1991 RDT&E and the fiscal year 1989 Aircraft Procurement appropriations were potentially deficient by \$14.1 million and \$21.1 million, respectively. Both fiscal year 1990 appropriations had very small available fund balances and were at high risk of being deficient in the near future. Uncorrected erroneous accounting entries for negative unliquidated obligations and progress payments totaled over \$1.8 billion and have the potential to further distort available fund balances. Also, DFAS-Denver did not track the use of \$208.6 million in current funds to finance obligation growth against former merged account unobligated balances and, contrary to DOD practice, permitted uncollected refunds totaling \$40.9 million to be used to finance obligation growth. Finally, \$432.2 million of refunds deemed to be uncollectible were not disclosed in Reports on Budget Execution and unclear DOD accounting practices for matters in litigation contributed to incorrect available fund balances. As a result, potential violations of the Antideficiency Act have occurred, and more may occur. We recommended that the Assistant Secretary of the Air Force (Financial Management) investigate the potential deficits in the fiscal year 1991 RDT&E and fiscal year 1989 Aircraft Procurement appropriations, fix responsibility, and report violations of the Antideficiency Act as appropriate. We also recommended that DFAS correct erroneous accounting conditions that caused material errors in Air Force fund accounting reports and institute adequate procedures to comply with fund limitations. We further recommended that the DOD Comptroller require the DFAS to implement DOD accounting practice for Air Force refunds receivable and amend the

DOD Accounting Manual to specify how matters in litigation should be presented in fund control and accounting records. Comments have not yet been received.

WRONG DEBTS CANCELLED

Report No. 94-023 "Payment Errors Related to Operations Desert Shield and Desert Storm," December 23, 1993. The Conference Report that accompanied Public Law 102-172 requested that the IG, DOD, monitor the Defense Finance and Accounting Service's (DFAS) actions on canceling military member indebtedness related to Operations Desert Shield and Desert Storm. Numerous personnel had complained about aggressive efforts to collect debts that were often due to pay mistakes related to the rapid mobilization. The Congress gave the DOD authority to cancel debts up to \$2,500. The audit concluded that 31 percent of 127,000 debts in one audit sample were inappropriate cancelled, and at one center \$15 million out of \$19.9 million in cancellations was unjustified. The DFAS Centers used specially-designed computer programs that did not follow the intent of Public Law 102-172 in identifying debts to be cancelled. Conversely, the computer programs did not identify many debts that were eligible for cancellation. Further, DFAS did not request an end to the debt cancellation program and Service members who continue to incur debts in connection with current Persian Gulf service could still have their debts canceled, which was not congressional intent. We recommended that DFAS correct significant unauthorized cancellations, identify and cancel additional eligible debts, and request an end to the debt cancellation program. The Director of DFAS nonconcurred and stated our recommendations for correcting the situation were too labor intensive and costly. Requisite records were not kept. To date no unauthorized cancellations have been recouped and the program remains in effect, although DFAS has agreed to end it. We will pursue the open matters through the DOD internal audit resolution process.

UNDISTRIBUTED AND UNMATCHED DISBURSEMENTS

Report No. 94-048, "Report on Uncleared Transactions By and For Others," March 2, 1994. Disbursing offices frequently make payments or collections involving funds belonging to other activities. This report discusses the need for more aggressive and effective DFAS actions to clear transactions timely and reduce undistributed and unmatched disbursements. Increased management oversight was needed to reduce net undistributed and unmatched disbursements valued at about \$34.6 billion as of January 31, 1993. The DFAS Centers took limited actions to research and resolve intra-Service disbursements that remained uncleared for extended periods, and actions taken were less than fully effective. Managers at DFAS Headquarters were not given complete and accurate information on the status of undistributed disbursements, including uncleared transactions. The DFAS Centers understated the numbers and dollar values of undistributed disbursements reported as more than 180 days old by about 860,000 transactions and at least \$7.2 billion. We recommended that the DOD Comptroller publish detailed guidance for clearing transactions and reducing undistributed disbursements. We recommend that DFAS improve procedures and controls over transactions that are not cleared promptly and issue specific policies for reporting undistributed disbursements. Management concurred with our findings and recommendations and aggressive actions are now under way to reduce the DOD unmatched disbursement problems.

LOSS OF FUND INTEGRITY IN DISBURSEMENT PROCESS

Report No. 94-054, "Fund Control Over Contract Payments at the Defense Finance and Accounting Service—Columbus Center," March 15, 1994. The overall audit objective was to evaluate the adequacy of procedures used by DFAS-Columbus for fund control over contract payments. Procedures used by DFAS-Columbus to control appropriation fund data were not adequate. Specifically, obligation and disbursement data contained in the Mechanization of Contract Administration Services system were not accurate; and sampled contracts contained \$208.1 million in errors requiring accounting adjustments, \$10.4 million in additional disbursement errors, and \$741,000 in disbursements not charged to the proper appropriations. As of July 1993, contracts at DFAS-Columbus contained \$3.1 billion in negative unliquidated obligations at the Accounting Classification Reference Number level, and 2,659 contracts had negative balances totaling \$408.0 million. Further, up to 50 percent of the contracts and 70 percent of the modifications electronically transmitted to the Columbus Center through Military Standard Contract Administration Procedures (MILSCAP) were initially rejected or were incomplete when DFAS-Columbus received them, and had to be manually reentered. We recommended that the Director, DFAS, turn off the existing MILSCAP interface, complete necessary accounting ad-

justments, and correct errors for the contracts discussed in the report. The Director, DFAS agreed with the need for better supervisory and quality assurance reviews and other actions recommended. However, he did not concur with the need to terminate the current MILSCAP interface, and only partially concurred with two other recommendations. We will pursue these issues through the DOD audit resolution process.

SECURITY OF PAY SYSTEMS

Report No. 94-065, "Controls Over Operating System and Security Software Supporting the Defense Finance and Accounting Service," March 24, 1994. The audit objective was to determine whether management controls over selected features of the operating system and security software used on the production and test systems were adequate to safeguard the integrity of DFAS data. The audit concentrated on the operating system and security software used by four organizations to provide computer support to the DFAS Centers in Kansas City, Missouri and Denver, Colorado. Those two DFAS Centers make about \$22.6 billion in annual payments on more than 390,000 payroll accounts. All four organizations had deficiencies in the implementation and control of operating system and security software. Any knowledgeable user could improperly access, add, modify, or destroy pay and accounting data, and enter erroneous data (accidentally or intentionally) without leaving an audit trail. The audit did not identify any unauthorized access to pay and accounting data. We recommended that DFAS, Defense Information Services Organization (DISO), and Marine Corps Computer and Telecommunications Activity (MCCTA) strengthen controls over the use of operating systems and security software and comply with established security requirements. DFAS and DISO concurred with the findings and recommendations. Comments have not yet been received from the Navy for the recommendations made to MCCTA.

DEFENSE BUSINESS OPERATIONS FUND ACCOUNTING

Report No. 94-082, "Financial Management of the Defense Business Operations Fund—Fiscal Year 1992," April 11, 1994. Significant instances of weak internal controls relating to cash management and accounting systems existed. Also, transactions were not always executed in compliance with laws and regulations. Internal controls were not in place to ensure that cash transactions were verified and transactions made for or by others were recorded in a timely manner. Internal controls were not in place to ensure that \$17.7 billion in intrafund transactions were properly identified or eliminated. Audit trails were inadequate for substantive testing, a general lack of uniformity of accounting systems existed, and the U.S. Government Standard General Ledger had not been implemented. Additionally, recorded transactions were not supported with adequate documentation. Accounting systems used for the DBOF were not in compliance with requirements of Title 2 of the General Accounting Office's "Policies and Procedures Manual for Guidance of Federal Agencies." The DBOF financial statements were not prepared in full compliance with the Chief Financial Officers Act of 1990 as implemented by Office of Management and Budget Bulletin No. 93-02, "Form and Content of Agency Financial Statements," October 22, 1992. Reports to the Department of the Treasury required by the Debt Collection Act were inaccurate, and a system to monitor and report debts from contractors required by that act had not yet been implemented. A subaccount for recording and reporting \$1.1 billion in capital assets had not been established as required by the DOD Appropriations Act. New activities were added to the DBOF in violation of the Defense Authorization Act for fiscal years 1992 and 1993. Real properties, which by law are under the jurisdiction of the Military Departments, were reflected as assets on the financial statements. The Defense Finance and Accounting Service generally agreed with our findings and recommendations. Comments on the draft report were not received from the Comptroller, DOD, and the final report requests a reply.

Chairman GLENN. The next witness is the Honorable John Hamre, Comptroller and Chief Financial Officer of the Department of Defense. Mr. Hamre, welcome again. We are running a little long this morning, but we have covered a lot of territory here this morning. We appreciate your being here and we look forward to your testimony.

TESTIMONY OF JOHN J. HAMRE, COMPTROLLER AND CHIEF FINANCIAL OFFICER, DEPARTMENT OF DEFENSE

Mr. HAMRE. Good morning, Senators. Before I plow into my statement, let me start by saying one thing. I walked in during this hearing where I heard lots of people saying nobody is taking responsibility. The problems we have in the Department are my problems. I mean, I have to fix these problems.

We maybe have had a legacy of people in the past that have not done that. I am responsible. In 2 years, Senator, when you want, and you ask for that hearing, I welcome you to ask for that hearing because I will come back, and if we haven't fixed these problems then you can ask the President to relieve me. But I am responsible.

May I also take a second to make a comment about an issue that was raised. I was not here when it came up, but I heard about it when I walked in, and there was a discussion about some individuals in the Department who received Presidential awards. I am very disappointed in the discussion. I am disappointed in myself, really, because I thought that I had been able to establish a relationship that I could have talked to your people separately about this matter.

These individuals received awards based on the recommendation of my predecessors, not me. Had I had a chance to do it, I also would have recommended they get these awards. These are the individuals that are working harder than anybody in the Department to help fix the problems that we have got.

Now, Senator, you asked, is there anything we can do with the OPM rules to get responsibility. I will tell you, it isn't changing OPM rules that would take faceless, gutless bureaucrats and turn them into brave people. What turns them into gutless bureaucrats is getting bashed in a hearing when they are exactly the people that are working hard right now to fix these problems, and I would ask you please to look into this. I would ask you to meet with each of these individuals. These are exactly the people that are working with me to try to fix these problems, and before we just say that they were rewarded for their ineptitude—that is not the case. They were rewarded for having tackled these very problems, and I would like to go through that with you if I could.

Now, if I may, I would like to quickly—and this is a long statement and, sir, may I ask that it be included in the record so that we don't have to go through everything here?

Chairman GLENN. Without objection, it will be included in its entirety.

Mr. HAMRE. Despite the way I have started, and forgive me for doing this, I really am glad to have a chance to be here. I suppose all of my predecessors have said that at some point in time in the past. I am telling you I am serious; I am glad to be here.

We have a troubled system in the Department, and I have been trying to do something about that and I intend to offer as candid and frank an assessment of that as possible. I honestly do believe, Senator Dorgan, that we do have people in the Department that are working their hearts out trying to make the system work. Unfortunately, we have given them such a flawed system that it turns innocent mistakes made by honest, hard-working people into colossal problems, and I would like to show how that happens today,

again not to duck any responsibility. I am responsible, and I really do want to come back to that.

Senator Glenn, you ticked off this morning the failings of our Department, and they are well known. I mean, we paid \$1.4 billion to contractors more than was billed last year out at DFAS-Columbus. We had \$19 billion of unmatched disbursements in September. I should say not all of that means that there is mispayment. It does mean that we can't match it up, but we should be able to match it up. Our system was designed to match it up and it isn't doing that, and that is clearly a failing. We haven't got a clean audit report from the CFO audits. Those are clear failings.

I have told you the following anecdote, Senator Glenn, but I have not had a chance to share it with you, Senator Dorgan—and, again, this is not to duck responsibility, but to give some sense of how far back our problems go. The very first comptroller for the Department of Defense was a man named James Warren, who was appointed by the Continental Congress, the second officer the Continental Congress ever confirmed. After having been on the job 3 months, he wrote back to the Continental Congress and said, I can't do my job. He said, there are 13 disparate payroll systems; they don't inter-operate with each other; they are open to fraud and abuse; people can sign up and get a bonus in one colony and then simply go AWOL and sign up and get another one some place else, and nobody is checking.

I told Dr. Perry about this and I said, sir, we have made great progress, actually, in the last 210 years; we have added 37 States and we have only added five more payroll systems. In fact, that is a little bit of a misrepresentation because we have only added five more military payroll systems. We also have 18 civilian payroll systems in the Department of Defense. This was as of 1991 when DFAS was created.

Now, I say that not to make light of, or to remove from my shoulders, the responsibilities I bear for trying to fix these problems, but I do mention it to say that we have to understand the deep-seated context for these problems that we have inherited. That is what I would like to talk a few minutes about with you, if I may.

At the core of our difficulties in the Department, frankly, is the way the Department was created. We are a collection of vertically-oriented organizations, staff organizations, that have been assembled over the years, first with the Department of War and then the Department of the Navy, and then they had an acquisition corps and a finance corps. We added an Air Force and it had its own acquisition and finance operations and a personnel directorate. Then we added the Department of Defense and we brought another directorate in for consolidating contract management and things of this nature.

What we did in 1947, when the Department of Defense was created, was to put a veneer over the top of that and call it the Department of Defense, but we still kept these vertical stovepipe organizations. Now, what is the consequence of that? What happened is that as we introduced computers into the Department of Defense; everybody chose to automate their vertical-oriented staff processes. That is why we ended up getting 66 finance systems in

the Department of Defense. That is why we ended up getting 161 accounting systems.

Each of the shipyards has its own unique accounting system, and they are all within the Navy. Each of the supply centers has its own accounting system, even though they might be within the Army or the Air Force or the Navy. So we have 161 accounting systems and 66 finance systems. What that has done, because of this vertical-oriented staff organization, is create extraordinarily complicated business practices in the Department of Defense because the business of the Department today requires us to work horizontally across these organizations, and I will show this in just a second. To do that, then, we have to create enormously complex business practices to make the system work.

Let me give you an example of this, and I want to discuss it in terms of the way we do contract payment. There are three charts that are in sequence here. This was the product of a detailed review we undertook to find out why we had \$19 billion of unmatched disbursements, and let me use the case of an F-18 as an example.

I will say the program manager in this case is the F-18 program manager and he builds his program. He gets support for it in the Department of the Navy. He brings it up to me in the comptroller's office. We go through it, we agree or disagree, we amend it. We bring it up here to the Congress and Congress reviews it, authorizes and appropriates funds for it, and then the program manager finally gets the funds. Once he has those funds, he then issues a request for procurement.

Now, he usually hands that off to—in this case, it would be someone else at NAVAIR, usually a contracting office at NAVAIR that actually goes through the process of negotiating a contract, the content of the contract, the details and this sort of thing. It goes to the contractor and the DCMC—that is, the Defense Contract Management Command—administers the contract, tells us when deliveries are being made, issues change orders, modifications to the contract. Then, as elements are delivered or progress payments are made, it modifies DFAS, the Defense Finance and Accounting Service. Then we will write a check for progress payments or we will write a check, hopefully, for goods and services really delivered, not in the case of fraudulent bills, and I would like to talk about that later on, sir. Then, once that is all done, notification of the payment is sent over to the accounting side of the house and we aggregate those reports and then provide an accounting back to the program manager.

That was the process theory, and this is the actual reality. Let me say this is a simplified version of this chart. There are actually 105 paper transactions required to do what I just described to you, and that is because we are wiring together, again, with paper transactions—paper flows—all of these vertical organizations that have to work horizontally to get their jobs done, to get that process done, but all their systems have been automated to go up, not sideways, if I can use that analogy.

As a consequence, if there is a small error in any one of those arrows, it results in an unmatched disbursement. Sir, this is why we have \$19 billion of unmatched disbursements in the Depart-

ment of Defense, and that is a terrible number; it is a terrible number. I need to put that in context. This is a little like the checking account my wife and I share—she writes checks and I write checks. The moment she writes a check and before I even get the statement, that formally becomes an undistributed disbursement. I mean, it doesn't mean it is bad or wrong. It simply means that a check has been written and we haven't gone through the formal process of reconciling it.

Once a month, when I sit down with the statements from the bank and I reconcile, it then no longer becomes an undistributed disbursement. But, in that process, for maybe 25 days it is an undistributed disbursement. So the \$35 billion that you were referring to doesn't represent fraudulent spending or anything like that. It is the flow inside our process between when checks get written and reconciled—and we write checks at over 300 places around the country. That is one of our problems, by the way, one of the things we have—

Chairman GLENN. If I could interrupt, to use the family analogy, you wouldn't pay bills voluntarily without knowing you had a bill out there.

Mr. HAMRE. No. That is absolutely right.

Chairman GLENN. Somebody would have to send you a bill for something. Unless you knew it was the monthly payment on your house that comes up all the time—

Mr. HAMRE. Yes, sir. That's is absolutely right.

Chairman GLENN. —and you knew it was justified, you wouldn't just go ahead and voluntarily send some money to Sears and Roebuck hoping that maybe some day you would have an account there.

Mr. HAMRE. That is absolutely right.

Chairman GLENN. That is what we are doing too often.

Mr. HAMRE. Yes, sir. If I could follow up on that, sir, where our system breaks down—we have a process where we only, in theory, pay bills on valid expenditures, but we have not integrated it into our accounting side of the house. So our distribution side is separate from our accounting side, and we have lots of different places that are distributing funds against an account, but they are never required to check the bottom line on the accounts as to whether there is money left in the account before they can write the check.

If I can again use an analogy, our problem is as though you have 15 kids and they are all in college and each one of them has a check book on your account and they are writing checks all over the place. It doesn't mean they are invalid, but at any point in time we don't know where we are. That is our current dilemma in the Department.

Chairman GLENN. That never happened in my family. [Laughter.]

Senator DORGAN. If I might just add to that using the family analogy, neither you nor your wife would send a check to somebody just because they sent you a bill. If they said here is a bill for \$85 for a ladder, one of you would ask the other—

Mr. HAMRE. Did you order that ladder?

Senator DORGAN. —did we buy a ladder?

Mr. HAMRE. Yes. I do this all the time with my wife. She orders flowers and sends them to people all the time, and I keep saying, are you sure you sent flowers to somebody? You are right.

Senator DORGAN. We are paying for things we didn't get, according to these reports, because we are not matching what we receive in the accounts.

Mr. HAMRE. Yes. I find, for example, this case at the Military Sealift Command very troubling, and it was in preparation for this hearing that I first learned about it. I find it very disturbing. I am disturbed in several dimensions. One was that we didn't have internal controls that would preclude this happening—we had internal controls that only caught the guy after he billed \$1.5 billion, and then we failed to follow up on those internal controls and the guy billed another \$1.5 billion. That is one problem where I am really troubled.

Senator DORGAN. On a ship that was decommissioned.

Mr. HAMRE. Yes. It is unbelievable. To me, that is really embarrassing. I would like to come here and be very defensive about how good we are, and I really do honestly believe most of our people are honest and are working hard. Then something like that comes up and it is unnerving. It is unnerving to me to sit here and tell you I am responsible because, frankly, I have 46,000 people out there in the finance and accounting business. Some might be crooks. I don't know, but I am responsible and I need to make sure that the systems we set up are really going to catch that sort of thing.

I stayed up most of last night thinking about this case, and spent this morning talking with my senior financial people to say, well, what are some systems that we could bring in as a catch in the near term to try to correct that. We have some ideas. We have to follow up on it, but I am troubled by it and there is no excuse for it.

Clearly, if you get a bill, you should check to see whether it had an obligation behind it. That is where the system broke down, and it broke down catastrophically in this case and I worry that we have others out there like that.

Now, one of the things we have to do to correct that is cut the number of sites—we are currently operating with 300 paying offices and 300 accounting offices. The complexity of our system is so great that it breaks down. Clearly, this guy knew that we weren't following the rules. You know, he had been in the system; he realized that people weren't checking and then he submitted bills. Part of that is because our system is so complex that it is easy to find those chinks in the armor, but no excuse. I am not making an excuse for what we are responsible for.

As I said, the reason we largely have \$19 billion of unmatched disbursements is because of the 105 manual things that have to be done, paper flowing back and forth; just a typographical error is going to produce an unmatched disbursement. Again, in your personal check book, if your wife writes a check and puts the wrong date, that becomes an unmatched disbursement that you have to reconcile manually, and we have thousands of these. That is what we are choking on and we really have to do something about that.

I am going to come back to show what our solution is going to be in a moment, and I have deviated somewhat from my written

text. Let me say, while this was a case we have for contract payment, it is also exactly the same problem that was behind our paying 1,100 people after Desert Storm that we shouldn't have.

What is embarrassing to me is we paid a few deserters for a year after Desert Storm, and again it was because we had a breakdown in our process; again, different boxes, but it was breakdown between the personnel side of the house that is supposed to report data and what we were getting on the finance side of the house. When we did the actual data bump—that is, get the computers to mash two sets of data bases against each other—we found out that we had been paying 1,100 people we shouldn't have. We also found out that we were paying 1,100 people that we should have that the personnel people had wrong in their systems. I mean, it goes both ways, so we need to reengineer our business practices to get around that kind of a problem.

I wish Senator Dorgan were here for him to hear me say this because I want it to be understood. I wrote this before I heard what was being said this morning in this hearing. One of the things that bothered me a good deal in coming over to the Department was the complacency that I saw in my own community to deal with these very deep-seated problems.

It was not a malicious complacency. It was not "this doesn't matter," but I think it was really a complacency that was created more from the view that these problems are so big, they are bigger than anything I can solve. Since we have learned to live with these problems, we went ahead and continued to live with these problems and we didn't really stop and say, is this the right thing that we ought to be doing.

I had a personal instance in my own office in this regard, and Mr. Vander Schaaf referred to it in our preparations for our presentation on the Antideficiency Act with the Senior Financial Management Oversight Council. I learned that we routinely write checks on accounts that are in the red. There aren't a lot of accounts, but there were like 23 accounts that were technically in the red, that Treasury said were in a deficit condition, and yet we were still writing checks on those accounts.

I said why are we doing this? Well, the assumption is that there are errors in the accounting system and that it will all get sorted out over time. I used a personal example. I said I had a case where someone, through an accident, I believe, billed \$4,500 worth of airline tickets to my Visa card. I said what motivated me to get it fixed was I couldn't use my Visa card until I got that fixed.

Now, I had to take the initiative to call and say those aren't mine, get them off my account. It took 2 weeks of not being able to use my card. It was quite inconvenient, but we in the Department have a system where it is not inconvenient because we keep writing checks even though we are in the red. And I said we are just not going to do that any longer; we are going to stop that process. It was very difficult. It took 2 months to get the Department to agree on this.

At one point in a meeting, I had to say let us pretend that C-SPAN had been sitting in this gathering and had been telecasting what we have just said to each other to everybody in America. Would you have wanted everybody to hear that? You know, we can-

not remain complacent to these problems, and I will say the system has turned and we have explicit policy direction. We are not going to write checks now on accounts that are in the red. It sounds kind of dumb, doesn't it, that this is something to be proud of?

Let me tell you, that is going to create all kinds of uproar and the first people that are going to hear about it are going to be you, Senator Glenn, and others on the Hill who are going to hear from contractors back home that are saying, "I have a legitimate bill, it is for services that were rendered and they are not paying me." The reason we are not paying them is we have a screwed-up finance and accounting system that we can't reconcile in a timely manner, but we are going to stop. For those accounts that go in the red, we are going to stop and reconcile before further payments—and it is going to be a difficult time for all of us in the Department. It is going to be a difficult time for people up here on the Hill because you are going to be hearing from people and you are going to be mad at me that I can't get a check written in a week to take care of that problem.

It may mean I have to come here on short order and ask for reprogramming to get money into that account so that I can make payment. I will do whatever it takes to get it working, but we are going to stop writing checks on accounts that are in the red. It is that kind of a problem that we have that is endemic.

Sir, I am now going to jump quickly into some of the other parts of my prepared testimony. We do have, I think, a blueprint for reform and let me tell you, in broadest degree, some of the elements of it. First of all, and it is something that both you and Senator Dorgan have been asking for this morning, which is we have got to make the current system work. The current system might be screwed up, it might be hopelessly complex, it might be overly engineered and gives you an easy opportunity to make a mistake, but it is still our system right now and we have got to make it work.

That is what we have been doing on the unmatched disbursement problem. In September, we had \$19 billion of unmatched disbursements. My first question was, are we long or short, but it doesn't matter. There are errors. We have to reconcile it, so the Defense Finance and Accounting Service—and, again, it is one of these individuals, John Springett, who received one of those awards, that directed this—set up tiger teams to start reducing this problem, and we have been working hard at it.

We now have the \$19 billion problem reduced to \$12 billion. It is a 37-percent reduction, and it results from dirty old pick-and-shovel work—getting those invoices, reconciling them, matching them—lots of extra hours by people out in the Finance and Accounting Service because there are two sides of the house we have to bring together. We bring the finance house together and we have to bring it together with the contract side of the house to reconcile these differences. It has been a lot of hard work and we have got it down below \$12 billion. It is still far too large a number.

There is also too much bad stuff coming in the front door every month. We still get about \$2.5 billion of unmatched disbursements every month, and we have to work that down at the same time we are working down the backlog. Too much of the backlog is aged, old, and I don't know if we will be able to reconcile all of it, but

we are working very hard at trying to do that and we have to do that.

In many cases, I should say it isn't that we are trying to match up the details of the contract to the details of the bill. We know that the bill matches that contract. We know it matches up that delivery of 24 aircraft, but there are all the detailed CLINs, the contract line item numbers, that we have to match up. That is what we haven't gotten done yet and that is what we do have to do because that is our procedure and we need to make that part work.

The second thing we need to do is reengineer this process. The current process is too complex. The fix is a two-step process. One is we need to take some of those arrows off that chart in the near term.

Chairman GLENN. Before you put that down, put it back up a minute. One of the theories, at least, with having program managers when that was put in was you were going to give the program manager a lot more authority and you were, in effect, going to give him a bag of money and run your program, and you are the boss and you are going to rise or fall on that. This doesn't quite follow that pattern. Has the program manager outlived his usefulness here?

Mr. HAMRE. No, sir. I think we have not done a good enough job of keeping up with the directions that Congress intended with the reforms in creating program managers, for example. We have still made that program manager plug into that network, and many times when we have had a reform, such as we have created a unified contract management command, we have created a whole new box with whole new sets of arrows that are required in the process. So what we have not done is been mindful in our previous reform efforts to the complexity that it was causing to the average GS-5's and 6's and 7's out in the field.

Let me give an example. After the \$750 million problem came up, I went out to Columbus and I said, what the heck is wrong here; why do we have all these dumb people writing checks to contractors that didn't send us bills? That is when I found out it was this kind of a difficulty.

We have GS-5's where a high school education is desired but not required. I mean, these people are working through contracts 4 and 5 inches thick trying to find and encode technical detail, where that very detail was already processed and confirmed to be right when it was in the DCMC box before it was sent over to us. Well, let us get that information from DCMC rather than DFAS having to rekey it and making mistakes in the process. It is that sort of thing we are trying to do to get some of the arrows off of this box. That is the near-term thing.

Our long-term solution—we have to find ways where that program manager, when he gets the appropriation from the Congress and puts it into his system electronically—my paying office people can electronically borrow that information. It is electronically shipped to them and they don't have to reproduce it and they can put it into their systems and we don't have a chance to make mistakes; again, these keying errors that keep coming into our system.

Most of these budget accounting codes are like 50 and 60 digits long. You simply turn two numbers around and you have an unmatched disbursement. The solution—get it electronically. It was put in right one time; let us not do it wrong a second, third, fourth or fifth time. This is our solution in the long run, and we need to do the same thing with the personnel system, for example. It is just as important for us to do it in that area.

I apologize. I am going far longer than I should have. Let me say what is the key to doing this, and you talked about it, Senator Glenn, when you asked about CIM, Corporate Information Management. CIM is the key to doing this. The problem is that we have developed all these unique finance and accounting systems over the years. As I said, we have 161 accounting systems. All of the data that is inside those accounting systems is unique to those individual systems and is not interchangeable electronically, or you have to come up with elaborate processes to change it.

So the name, date of birth, rank, serial number, and Social Security number will be in 18 different personnel payment systems and they will not be interchangeable. We need, through data standardization, which is one of the key elements of CIM, to get that down. We have over 100,000 unique data elements in the finance and accounting world. Through detailed analysis, again at DFAS, and detailed modeling, we know we can live with only 900 data elements. We can go a 2-order-of-magnitude reduction.

Obviously that saves you enormous sums of money. You don't have to engineer new entitlements, legal entitlements, into 18 different systems. You can do it once. I mean, it is a tremendous breakthrough for us if we can get it done. The Department has done well in data standardization. We have been at this now for 3 years, working very hard at it, and to date we probably have over 300,000 unique data elements. To date, we have had agreement on two Department-wide.

Now, the Secretary commissioned us to try to jump-start this. We can do our entire operation with 900 data elements. We think we will have 500 of them agreed to by the first of August. We hope to have 90 percent of them agreed to by the end of the year. This will be a big breakthrough for us to start getting into the new, modern finance and accounting systems.

Let me say one word about the finance and accounting systems themselves. As I mentioned, we have 18 separate payroll systems for military personnel. Obviously, it is extraordinarily expensive to keep up 18 unique systems, lots of opportunities for mistakes. A new entitlement comes in and we have to engineer it into 18 separate models.

I will give you an example. On the civilian side, we have 18 civilian payroll systems; we are going to get that down to just two. Today, on the average, the average payroll clerk services 350 customers. When we get to our new target system, the clerk is going to service an average of 1,500. In other words, we will have a five-fold increase in productivity through systems modernization. That is why we are going to be able to shrink in the finance and accounting world from 44,000 people down to 22,000 people over the next 5 years, and that is what we have to do.

Sir, let me defer on DBOF unless you have a question, and I know I may have another opportunity to talk with you about that, sir.

Chairman GLENN. Fine.

Mr. HAMRE. My last point in our blueprint was—and it is probably fitting to come back to this now—to try to create an atmosphere of candor and honesty in our system. This Committee has a very distinguished history of bringing the problems to the Department's attention, and too often the response that you got, Mr. Chairman, was kind of stony silence.

I think that the Department tended to feel that these were nuisances. It was something that wasn't a central responsibility. It kept them from getting on with the main agenda, which was to arm and resource the Services against a large threat. I think maybe we kind of lulled ourselves into complacency, hiding behind the threat, to ignore these longstanding problems.

You have been a voice crying for some change for the last 10 years. It is our view that we have not lived up to your expectations of us, and I know you are a strong supporter of Defense and it is very hard for you to be our advocate when we have not been forthcoming in dealing with you with our problems. I would say the same to Senator Dorgan because I know of his very strong commitment.

Our responsibility is to return to you, in honesty and candor, the trust that you have frankly been giving and expecting of us to clean up these problems. We are going to do it, and that is why I would like to return at the very end to say I do consider myself personally responsible for this and I would like you to ask me to come back a year from now, the following year. How are we doing?

Chairman GLENN. We probably won't wait a year.

Mr. HAMRE. All right, sir. Let me end at that point and answer any questions you have.

Chairman GLENN. Thank you very much. Let me come back to CIM just a minute now because we have had testimony before that that seems to be critical to a lot of the management problems of the future. Just the things that fit under CIM—command and control, finance, materiel management, distribution, procurement, and human resources—you can easily total up about \$88 billion a year that comes under that. That is a big item.

Once you get CIM in operation, will all these different systems be able to talk to each other, or are they still going to be separate systems? The other question is, one of our estimates from someone was that it may take another 10 years-plus to implement CIM. Is that the estimate?

Mr. HAMRE. Sir, it is hard to appreciate the complexity of the problem, and we experienced it in the finance world. For example, I mentioned to you that we believe we can do our entire business in the finance world with only 900 data elements. It turns out that only 25 percent of those data elements are unique to the finance world; 150 of them are in the personnel world. The way we have set up the CIM process, I cannot standardize my systems DOD-wide on personnel issue items. That community has to be the one to take the lead.

So we are all a little like the children of Israel wandering around in the Sinai Desert waiting for somebody to put a tent peg in the ground and say, OK, here is where we are and let us start working around this point at this point in time. That is the reason we have gotten nowhere on data standardization. Nobody wanted to settle down because they only owned a small piece of the overall problem and they didn't want to give up their piece to somebody else to get the ball rolling.

Chairman GLENN. I understand, but there has to be direction coming on this if this comes down to consensus versus orders being given. I know it is nice to put out the ideas and say, yes, everybody sees the wisdom of this and we will all cooperate. But if you have two or three recalcitrant major players who say, I don't like that because it is going to upset my apple cart and I am going to have to make some changes, then somebody has to say, here is what you are going to do and you are going to do it now. It has to go downhill and they have to implement it, and that is the way organizations work, including the Pentagon.

Mr. HAMRE. Yes, sir.

Chairman GLENN. Certainly, in a military organization you give orders from the top and they get carried out, and if they don't, some heads roll.

Mr. HAMRE. Yes, sir.

Chairman GLENN. Obviously, I would prefer to see things operated on a consensus basis in the organizational aspects. If they can't, you may have to resort to a military operation and say, here is how it is going to be and those who can't operate under this seek other employment. Now, I am not sure you can do that under civil service rules, and that is the reason why I brought this up earlier once before you were in here today, and I wasn't completely facetious in this.

I am wondering if we really can get accountability downhill. If you decide with your best advisers over there that something has to be done in a certain direction, and that is it, and the Secretary of Defense, Dr. Perry, backs you completely—and he has told me personally he thinks your job is absolutely vital; he is making this a priority and, finally, at last, after all these years, getting this financial management under control.

Then if he backs you completely and you say, OK, here is the way we are going to go, now comes the big question. Is everybody going to hop to and do it? If they don't, then what can you do about it? I am not sure but that we may need some changes in enforcing some of your things if we go along with the existing civil service.

I am not talking anybody down. I know you have as many dedicated people over there as anybody in all of Government, but you also have a very difficult situation. It is more complicated than GM or somebody like that, but GM and somebody who has a budget bigger than—Ed Cole used to tell me—I am not sure you were in the room when I said this earlier—used to tell me that they had a bigger budget in GM than eight governments around the world.

Now, I know what happens when there is somebody not performing. They are taken out and either given another job or they are let go, and that is a great goad to efficiency and productivity. I am not sure that with civil service laws right now the way

they are that we could fire somebody if they weren't efficient or if they said, well, Mr. Hamre, I am sorry, we have always done it a different way and I just don't want to change and I am going to keep submitting my forms. Could you fire them? I am not sure you could. That means accountability goes down the tubes unless they know that something is going to happen if they don't agree with orders from on top.

Now, in the military side of the Pentagon that is no problem. You give orders and they get obeyed, or else. Over on your side, the civilian shop managing all of these things, do you need some help in this area? Do you feel that your authority to demand changes is sufficient?

Mr. HAMRE. Sir, I have only had one direct personal experience along this line in the 6 months that I have been in the job, and frankly it revolved around this issue of data standardization. When I asked my organization, I said I want to move this very quickly, I want to get these items settled this year. I felt, probably wrongly, that the individuals—they were trying to counsel me about how hard this was going to be, and at one point in time I said to one—look, you are a very good civil servant and I will find you another job, but I need someone in this job who is going to do what I need done here.

From that day on, I have had absolutely nothing but raging support from these people. I mean, I think that where I have problems it is systemic—again, I will use data standardization as an example. Of these 900 data elements that I can get by with in my whole world, I only control a quarter of them, and so I am relying on civil servants in other directorates in the Department to get the ball rolling in their area.

Chairman GLENN. Let me follow up on that a little bit. Now, you are the Comptroller of DOD.

Mr. HAMRE. Yes, sir.

Chairman GLENN. The financial management of each one of the Services comes under your oversight and direction.

Mr. HAMRE. Yes, sir.

Chairman GLENN. What is the difficulty with going downhill and saying, Army, Navy, Air Force, Marine Corps, here is what I need and I need it at a certain time?

Mr. HAMRE. Well, in this case it is that I need to go to my counterpart under secretaries in OSD and say, I need you to be moving these things along in the acquisition and personnel worlds. Now, I have done that and they have been very supportive. What I have found, instead, is that, frankly, at the next level down, those people are desperate to be led. I asked for a meeting and I said, why can't we get this done, and they said, we can get it done; lead us, we will do it.

I don't think others have had the opportunity I have had to see how important this is to get fixed. I think CIM is critical for us. It is making a difference for us, sir.

Chairman GLENN. I am not going along with these comments here to be antagonistic. It is quite the opposite.

Mr. HAMRE. I know that.

Chairman GLENN. I want to back you 100 percent and I am trying to get to whether you have the authority, with the Secretary

of Defense's backing, to do those things. Find and float an idea and say, OK, let us get consensus on this and I hope everybody drops in line. If they don't, then there has to be some pretty heavy-handed movement over there, quite frankly, and it has to be on that basis that here is what we are going to do.

Mr. HAMRE. Yes, sir.

Chairman GLENN. And the Secretary of Defense backs you and that is the way it gets done. Do you have that authority?

Mr. HAMRE. I believe I have unquestioned support from my boss, from Dr. Perry and from Dr. Deutch. I know they will back me up if I can demonstrate to them that this is important. I have no doubt of that.

We have laid out a goal this year with very specific, measurable criteria. We want a 75-percent reduction in all of our finance systems by the end of this year. We want a completed coordinated streamlining plan for all of our accounting systems by September. We want \$200 million worth of auditable financial savings by the end of fiscal year 1995.

We have very specific goals that we have set for ourselves, and I believe that if there is anything along the way that looks like I can't achieve or the system isn't working to achieve, I believe the Secretary will back me up. The tool for us to do that is the Senior Financial Management Oversight Council.

Chairman GLENN. Let me ask one thing here. In some of my briefing things that the staff prepared, it had this note in it and I want to find out if this is correct. DFAS does not have the authority to make military bases check their records as needed for an effective reconciliation of mismatches. Is that correct that you can't go down to a base, to Fort Hood or Fort somebody, and say we want to check your records so we can pick up these mismatches, and so on, and do the auditing, whether they are doing a good job or not? Can you do that?

Mr. HAMRE. Sir, I would want to make sure I knew precisely the example, but it is very conceivable that this is the case. Again, it is this case in all six of these different boxes that have to work together. It may be that the accounting element at a certain base is not under DFAS at all, and it may be an Army- or Air Force- or Navy-unique activity. In that instance, they cannot compel reconciliation.

Having said that, I have meetings every week with the financial management community of the Services and they have been working with us. Of our \$19 billion problem, 14 of it was with the Navy in unmatched disbursements and the Navy has been working assiduously with us to try to get this reconciled. I don't know of a single instance where we have not been able to do something because somebody has refused to cooperate with us, but I will follow up on that.

Chairman GLENN. Does your office, in effect, through DFAS, have the authority to go down to a base and say we need to reconcile some accounts here; I want you to do it now and get me the report by Tuesday?

Mr. HAMRE. DFAS may not be able to, but I could do that on its behalf through a Service secretariat. I will have to check on that.

Chairman GLENN. What I am nibbling around at, I guess, is do you feel you need any legislative changes that we can put into the defense authorization bill this year that will help you? I would be more than happy to do whatever you think you would need.

Mr. HAMRE. Sir, will you let me get back with my people and check and find out? I appreciate the offer and I would like to find out if there are some authorities that we need to be able to do that. I will do that and get back to you within a week.

Chairman GLENN. All right, and you might want to think about this civil service change, too. I don't want to scare all the civil servants to death all over the country, but we have done some things with Defense before that gave Defense a little head start on some other agencies here on, for instance, the early-out thing. That worked well over there and so we tried it at other places. Now, OPM and Jim King are in the process of redoing some of the civil service rules right now and they will be making proposals to us later this year, we hope, which we will be considering.

Now, I want to make sure that you have authority that if somebody has to be moved, there isn't a civil service rule that says you can't move them and we go through this whole routine here. If you are going to have a good organization over there, you are going to have to have authority to bring accountability.

Mr. HAMRE. Yes, sir.

Chairman GLENN. And that has to go from top to bottom. You may feel you are accountable, and you are, and say that a number a times, but accountability means all those people under you carrying out what you are accountable for, too. So you have to have your team playing in that regard.

Mr. HAMRE. Yes, sir.

Chairman GLENN. Earlier today when I was talking to staff before we came to the hearing here, I was thinking back to some of my past experiences in a different incarnation when we used to have on the wall a perk chart, and it was a big one. This was in NASA in the space days when you had to have all sorts of things come out here and you had to hit certain time lines.

Have you ever thought or considered making a big perk chart and in each one of these different areas setting a goal for what DFAS has to do? Here is a time line and it is on a base here and everybody gets the distribution of that, and here is what is expected of you. You might ask those people to help set their own time line—the Iacocca way of managing, I guess—and let them tell you what they can do and then hold them to it.

You set a goal for everybody, and you might have a big perk chart over here that does that in all these different areas, and with each service, maybe, even. Then people have their own visible objective they are working toward by a certain date and that is the way you get at it. I can't accept this thing that CIM is going to be around still being worked on 10 years from now before it becomes effective. I don't think that is right.

Mr. HAMRE. No, sir. CIM has become effective for us almost immediately because we have already downsized the finance system.

Chairman GLENN. It may be 10 years before every I is dotted and t crossed, and all that sort of stuff. But if CIM isn't available for

effective use far sooner than that, then we have missed our whole calling with CIM.

Mr. HAMRE. Sir, I really think it is, but I agree with you. I have asked for some of these time line charts in specifically the migration plans. Let me follow up on that and see what I can do. It might be a very useful device to communicate to you what we are doing.

Chairman GLENN. Two or three fast questions here. On computer security, do you see that as a major problem as we move along with CIM?

Mr. HAMRE. Yes, sir. Again, I mean it very sincerely. Hearings like this become very important to focus my attention. I did not know about this problem until I was getting ready for this hearing. It is a problem. I sat and I talked briefly with Derek, with the IG, and we have a plan that we are working on right now with DFAS, but we do have a problem. We will fix it.

Chairman GLENN. It is a big, big problem.

Mr. HAMRE. Yes, sir.

Chairman GLENN. We have seen the fraud and how innovative people are with regard to fraud and embezzlement. It seems to me tapping into the system is going to be absolutely critical.

Mr. HAMRE. Absolutely; yes, sir.

Chairman GLENN. The DBOF implementation plan has gotten off to a start. It appears some of the milestones are beginning to slip. The issuance of the guidance, a relatively easy thing to do in comparison with some of the other things, is far behind schedule. What is going to be done to catch us up?

Mr. HAMRE. Sir, we are somewhat behind. I don't think it is as serious as some people may think right now. There were something like 60 specific objectives that were laid out in the implementation plan. We have completed about half of them right now. I think there are five, by our internal calendar, that are 6 months behind milestones when we are going to have them done. I worry about that because they are some of the bigger ones, some of the harder ones.

Chairman GLENN. We supposedly are off base on our accumulated operating losses that have been estimated at \$1.7 billion by the end of fiscal 1994. DBOF was supposed to operate on a break-even basis. Why is it losing money to the tune of \$1.7 billion?

Mr. HAMRE. I am trying to decide if you want the 15-minute answer or the 2-minute answer. You want the 2-minute answer.

Chairman GLENN. Summarize the 15-minute answer.

Mr. HAMRE. Yes, sir. We are losing money in DBOF for two reasons. One is we thought we got it right in setting the DBOF rates for fiscal year 1994, and we didn't learn until actually we were into fiscal year 1994, that we hadn't set them properly. We had basically underestimated in a couple of major accounts. That is one big reason that we are losing money in DBOF.

The second reason—and this is by far the larger and more important problem is loss of business. DBOF is working in the field and a commander has seen his prices go up to get an engine overhauled; they have virtually doubled in the last 3 years. These are rational economic creatures and they are saying, my God, I have

to find some other way to do this; I can't keep sending engines into depot. So they are repairing more of them.

Chairman GLENN. Is part of this having a good accounting system in DBOF itself?

Mr. HAMRE. Sir, one of the key problems we have with DBOF is that we didn't have good accounting systems to start it. The central reform of DBOF was to fairly and accurately reflect the true cost of doing business. Of course, that means you have to have a good cost accounting system. We don't have a good cost accounting system. We have 161 accounting systems, and I don't know how many of them are any good.

But they are the things we have to operate on day in and day out, and so we launched DBOF as a major reform, not realizing that effective systems were not in place and that is a big limitation.

Chairman GLENN. Is it not possible to have these accounts not paid until we have a bill sent in or until the program manager or somebody says, yes, we owe this amount, so there is some verification for it? The staff handling this thing said what we are doing now is, effectively, we are providing a welfare plan with additional checks on the assumption that they will be on welfare sufficiently long to use up the money. That is not too bad an analogy, actually.

Mr. HAMRE. Well, sir, I wouldn't agree with it, but I think by and large our disbursement system truly does revolve around having a valid bill. It does require someone who is an authorized agent of the Government to authorize the disbursing of funds. That parts works. There is a disconnect between the disbursing side of the house and the accounting side of the house.

That is not the same as the problem that you brought up, Senator Dorgan, which is where you can get an individual—we have these fast payment procedures for \$25,000 or less, and here what you are relying on is, again, somebody to go back after the fact and make sure that that bill is correct—you know, we give them a detailed print-out of all the disbursements.

Chairman GLENN. Yes, but we don't have a \$41 billion unmatched account out there because of the under \$25,000.

Mr. HAMRE. Oh, no, sir; no, no, no.

Chairman GLENN. That would be a tiny part of it.

Mr. HAMRE. But the 41, or whatever the number is, is revolving all the time because it is getting matched up every month.

Chairman GLENN. Senator Dorgan?

Senator DORGAN. Well, I regret that I have had to meet with some other folks during your testimony, Mr. Hamre.

Mr. HAMRE. I understand.

Senator DORGAN. When I used the McGill case that was raised, I don't that for any reason except to say that the trail of trouble usually starts with something easily understandable and leads to something much more complex. I don't underestimate the problems of trying to deal with an F-18 and the billing and the engineering changes that go with the contract and the progress payments. That is an enormously complex process.

Yet, if we have failures on something as simple as someone just sending in a bill for services or products for which they have not provided anything to be applied to ships that are decommissioned—I mean, if the failure exists there in such a simple application, one

wonders whether the failure is not almost nightmarish in the more complex situations. That may not be true, but it—

Mr. HAMRE. I worry about that, too.

Senator DORGAN. I respect your comments about the employee awards. The previous testimony this morning set out certain awards. I would like to find out—

Mr. HAMRE. I would like to bring that to you. I would like to go through that with you, sir.

Senator DORGAN. I understand, but from the outside, not knowing much about this—and I almost regret that I am required to, serving on this Committee. I mean, I served 10 years on the House Ways and Means Committee. You know, I enjoyed the economic issues, but starting to get into this stuff is very complicated. I think that the question is how do we get to the point where the management of the dollar here is a management that we have some confidence in.

You say that a couple of years from now we should have you back, and I will still be here a couple of years from now, so I hope we will do that.

Mr. HAMRE. I hope I am here a couple of years from now, too.

Senator DORGAN. Well, my position is more certain than yours at the moment—

Mr. HAMRE. That is true. Four years is another matter. I don't know.

Senator DORGAN. —only because of the Constitution and the recency of my election. But I do hope we can do that, and I hope very much that we don't have these kinds of reports. I understand that you can't sort of gather all the things that are going on in this behemoth organization and assert to somebody that if there is a problem, we are going to correct it and we are going to do it now. I mean, the fact is some of these flaps on the tent are going to flap up from time to time.

But the discussion we have heard today from GAO talks about systematic problems that require a real effort to correct, and your presentation gives me some hope. I know you are new and I know that you have a distinguished record prior to accepting this post.

If, 2 years from now, we have another hearing, Mr. Chairman, as Mr. Hamre suggests, and we get a rosy report with glowing progress, you will have achieved your place in history.

Mr. HAMRE. Well, could it be rose edges around the petals? Will that do?

Senator DORGAN. No, no.

Mr. HAMRE. It may not be entirely rosy.

Senator DORGAN. I appreciate very much your testimony today.

Mr. HAMRE. Sir, I think when you raise this issue of what happened with this MSC case, to me, that became very unnerving because we have probably tended to engineer our systems to protect against the great big things, like the F-18s and stuff like that, and we have an army of people that are looking at these things day in and day out. It is so corrosive to your confidence in a system for a guy, frankly, just to print up invoices and send them in once a month and nobody is checking. I mean, that is very corrosive to my confidence in how the system is working, to your confidence in me that I am on top of it.

I take very seriously this thing. I am going to learn more about it and figure out what we can do about it. I think we have taken some initial steps, but they are probably not enough.

Senator DORGAN. Well, it is as symbolic to control in the financial systems as the \$500 hammer was to integrity in procurement reform. I mean, what undid what was going on in the mid-1980's, and showed the need for procurement reform, was finding out what we were spending for toilet seats and for hammers and ashtrays. This sort of thing that erodes confidence in the Pentagon's financial management.

Mr. HAMRE. Absolutely.

Senator DORGAN. I might say that the Chairman of this Committee, I think, has done more over a longer period of time on these questions than anybody serving in either House of the Congress. It is to his credit that he just sort of keeps hanging on to this bucking horse. One would expect a whistle one of these days to say the ride is over and he has succeeded and he gets all these points for it, but it just continues to go on and on because the problems are so enormous.

Again, Mr. Hamre, thank you for your testimony and I look forward to our next hearing 2 years from now.

Chairman GLENN. Thank you. I would just say the Norfolk case disturbs me, too, because I don't have a feeling that we really have a system yet that will catch things like that. What if we have 20 more people down there right now doing the same thing on ships that are still in commission? The only reason he got caught was because somebody realized it was a ship out of commission that he was still billing things to. That is the only reason he got caught, so the people are not changing this or are not checking what goes on closely enough to catch similar cases like that right now, as I understand it.

Mr. HAMRE. Yes, sir. One of the things I was speaking with Rich Keevey, who is my deputy, about this morning—and he was originally supposed to come down to be the CFO for the Department of Defense, something that I hope we can talk to you again about some time. I asked him, what did you do in New Jersey, where he was the state OMB Director.

Maybe there are some things we can do in the near term. For example, I don't know if it is possible to bump up a list of all of our vendors against IRS records just to find out if they paid taxes any time during the last year or the year before—something outside of the system that we can come in with as an early-warning device to send off some alarm bells so we don't have a case where a guy just makes a mistake and that is the first inclination we have of this. I don't have a solution to this, but I recognize how important it is.

Chairman GLENN. We are going to have to end. I appreciate your being here, and I know from our talks both in Committee work and prior to your taking the job over there—I know of your dedication to getting this thing done. That is what we want to do, is get it done, and any help you need from us, let us know, and we will be on your back and on your neck and whatever to help make sure that it gets done. We appreciate your being here this morning.

Mr. HAMRE. I will be back to you within a week, sir.

Chairman GLENN. Thank you.
Mr. HAMRE. Thank you.

PREPARED STATEMENT OF JOHN J. HAMRE

Thank you for the opportunity to appear before you today concerning the financial management reforms we have undertaken in the Department of Defense. I consider this testimony a unique opportunity to present to you our plans for reforming our financial management systems. Not all of my predecessors would have considered testimony before this committee to be an opportunity, despite what might have been said. But I sincerely do welcome this opportunity to appear before you and share with you what I have learned in the 6 months since I have been sworn in as Comptroller for the Department of Defense.

I intend in this testimony to present to you a frank and candid assessment of the state of our financial management systems. Secretary Perry answered for the Department, and certainly for me, when he answered a question you posed, Senator Glenn, to him during his nomination hearing. You recounted the recent history of shortcomings in financial management systems in the Department and asked for his comment. He responded "I fear it is worse than you have stated."

May I offer one last comment by way of introduction. I have only one reservation today in offering so candid and blunt an assessment. I fear that without proper context my comments might undermine the spirit of the 46,000 dedicated public servants who work in the financial management area. Despite all of our problems, I am convinced the Department is doing a good job of managing the resources provided by the Congress. But we are able to do this because of an army of dedicated public servants who are working to overcome the limitations of the tools we have given them.

Long-standing financial management problems

We have inherited a troubled system. Its failings are well known.

- Last year we paid defense contractors \$1.3 billion more than we should have and had to recover that overpayment.
- After the conclusion of Operation Desert Storm, we continued to pay 1,100 personnel after they left the Army. Sadly, we even had instances where we paid deserters.
- Last September DOD could not match some \$19 billion in disbursements to specific requirements in acquisition contracts.

I do not want to lay these charges at the feet of my predecessor, for he too inherited this flawed system. Indeed, our deep-seated weaknesses stretch back to the founding of the Republic.

In 1775, the Continental Congress appointed James Warren to be the first Paymaster General. He was in effect the first Comptroller for the Department of Defense, my predecessor. After 6 months in the job, he wrote to the Continental Congress saying he could not do his job properly because of the flaws in the financial management systems he inherited. He complained that each of the 13 colonies insisted on its own payroll system and they were not standardized. The overall system was open to abuse. Frequently individuals would sign up for the militia for one colony to receive the sign-up bonus, only to desert and join another militia to receive its bonus. Pay was not standardized. Uniforms were not uniform. It was chaos.

When Dr. Perry asked me to undertake a thorough assessment of our financial management systems, I reported back to him that we have actually made tremendous progress in the past 200 years. We have added 37 States to the Union and only 5 additional payroll systems.

Legacy of vertically-oriented, chain-of-command organization

Seriously, our financial management problems in the Department of Defense do trace back to the founding of the Republic. I am not trying to lessen my responsibility for changing things by implicating my predecessors in the problems we face. But no enduring reform is possible without properly understanding the true causes of our problems.

The financial management failures of our system spring ultimately from our formal organization. When DOD was established in 1947, it retained the existing organizations with their vertical chain-of-command mode of operations. This vertical chain-of-command organization is essential for success on the battlefield, but it had distinct consequences for peacetime operations. Management systems, including financial ones, were geared to report information up through these vertical channels. When computers came along and every organization sought to automate its proc-

esses, these organizations were not compelled to emphasize horizontal connections across organizations of like functions, such as pay or contracting. Instead, computers were used to automate formerly manual procedures. Financial management systems were designed within the chain of command to support the commander of that operation.

At the same time the business of defense in the past 50 years has demanded an unprecedented degree of integration of functions. As the Department of Defense matured, certain activities—such as contract management—were made common across the Department. But this process of standardization really produced yet additional collections of vertically-oriented chain-of-command organizations.

(Chart 1) My first chart summarizes the consequences of these developments. The legacy of this organizational history is a Department filled with redundant and non-uniform financial management systems. In 1991 when the Defense Finance and Accounting Service was established, there were 66 major finance systems and 161 major accounting systems. Thus, the Department had to create enormously complex business practices to integrate horizontally the necessary functions of the different vertical organizations which had to work together to accomplish the tasks of arming and equipping the military forces in the post-war period.

We learned this painfully simple truth when we set about trying to determine why the Department had so much difficulty matching obligations and disbursements. A good illustration of our findings is the process required to procure a weapon system.

First, let me briefly discuss the theoretical functioning of our system. I will use the F-18 fighter as an example to illustrate the problem. (Chart 2) The chart contains six boxes. In the instance of the F-18, the program manager is in the Navy Air Systems Command. He develops a problem, secures the support of the Navy, defends his budget request inside the Pentagon and ultimately before the Congress. Once the funding is secured, he issues a request for proposal and initiates the procurement process. At that point he hands the problem over to the contracting office, which in this case is also within the Navy Air Systems Command. This office actually awards the contract and negotiates its content. At that point the contractor proceeds to work on the procurement. The contractor sends contract information, invoices, and delivery notices to the Defense Contract Management Command. This is a DOD-wide activity in the acquisition community. DCMC administers the contract, issues modifications to it, accepts and approves deliveries of goods specified under the contract and notifies the Defense Finance and Accounting Office that it has received the goods, permitting DFAS to make payment on the invoice. After the payment has been made, DFAS sends that information to one of its accounting offices which provides detailed accounting detail back to the program manager.

That is the sequence of responsibilities. But now look at the flow of paperwork. (Chart 3) This chart illustrates the primary paper transactions required by this process. Indeed, this is a simplified representation of the actual process. It takes 105 actual transactions to complete the full process.

Why is this so? The problem stems from the fact that the process involves separate vertical chain-of-command organizations. The program manager, and contracting offices in this example were Navy acquisition command offices. DCMC is a DOD-wide acquisition activity. DFAS is a DOD-wide finance activity. (Prior to DFAS there were service-specific finance and accounting activities.)

Unfortunately, buying F-18s is a functional activity that requires a great deal of horizontally integrated activity. So to make the vertical staff organizations accomplish this task, we have engineered enormously complex business practices.

This complexity is the primary reason why we had \$19 billion in unmatched disbursements. An honest, innocent mistake in any one of these paper transactions can produce inconsistencies that require extensive manual research, which results in a build up of unmatched disbursements.

While the paper flows are different, this also is precisely the underlying cause of problems that had us pay 1,100 soldiers for months after they were discharged following Operation Desert Storm. Our personnel systems are not integrated with our payroll systems. We did not have a problem with pay and personnel in the Air Force or the Marine Corps, largely because we have reliable integration of pay and personnel systems for those two services. But we lacked that integration for the Army, and we paid a price for it.

Complacency about Financial Management Problems

I have found that the financial management community was well aware of its limitations, and adapted to these shortcomings. In part, this was because the solutions were perceived to demand actions far larger than any one organization would manage. I have frequently said that our financial records are the thermometer that

registers the fever caused elsewhere in the body. The shortcomings show up in our financial records, but they are caused by far more deep-seated problems. Knowing that, it was all too easy for my community to become complacent in the face of our shortcomings.

I recently experienced this problem personally. In February, the Senior Financial Management Oversight Council met to consider the Department's compliance with the so-called Antideficiency Act. Dr. Perry created the SFMOC precisely to deal with long-standing problems in the Department. In preparation for that review, I learned that the Department routinely disburses funds in excess of available balances in individual accounts. In colloquial terms, the Department routinely writes checks on accounts that are "in the red" under the assumption that these accounts are in the red because of innocent accounting errors. I personally believe that these are largely innocent accounting errors, but we also adopted this approach because of the enormously complex disbursing process we have created over the years. To facilitate contract payment, we have charged disbursing offices to pay any "authorized" invoice. We presume that whoever authorized payment first checked to make sure there were funds in the account. The consequence is that multiple individuals have access to the checkbook and no one is responsible for checking the balance first before the check is written.

I found this totally unacceptable as a practice. Again, I accept the premise that negative balances reflected innocent mistakes. But we have created a system where no one feels it is their personal responsibility to correct the mistakes before we go any further. I encountered great reluctance to change our way of doing business, not because they felt this was the right way to do business, but because this practice was designed to accommodate the complexities of our overall system and the complaining will be bitter when it changes. We are changing, and I fully expect a firestorm of protest as the system adjusts. But we can no longer acquiesce to our systems shortcomings.

Blueprint to Reform DOD Financial Management

As I pledged during my confirmation process, I consider as my greatest responsibility the reforming of DOD financial management. I doubt that I will be in office long enough to witness the full impact of our reforms. But I must take these steps, building on the reforms I inherited from my immediate predecessors, if we are to correct these long-standing problems.

The Department has adopted a six-element blueprint to solve its financial management problems.

Strict compliance with current requirements. The current system may be inefficient and redundant, but it is the system and we have to make it work better until we can change it. I am pleased to report to you that we are making progress in this regard. Last October the Senior Financial Management Oversight Council met on the problem of unmatched disbursements. As I said, at that time we had \$19 billion unmatched disbursements. Dr. Perry gave us what seemed like an impossible goal—to reduce that number by 50 percent by July 1. All of the old professionals in the financial management world said it could not be done. And we are not there yet, but as of February 1, we had that reduced to \$12 billion, a reduction of 37 percent. This progress is purely the result of hard work by dedicated individuals making the current system work. We have to do more of that until we can solve the underlying problems.

Re-engineer business practices. One of the buzz-words of management today is re-engineering business practices. But clearly that is the solution to our deep-seated problems. Long-term solutions will depend on re-engineering DOD business practices to break down the barriers that persist from the legacy of the past.

There is both a near-term and a far-term dimension to this re-engineering task. Returning to the example of the F-18 contract payment, in the near-term we need to find ways to get arrows off this paper flow chart. And there are ways we can do that. For example, currently both the Defense Contract Management Command and the Defense Finance and Accounting Service enter basic contract data into separate computer systems. Simple key stroke errors create the raw material for unmatched contract disbursements later on. We are exploring ways to have DCMC enter the contract data once and provide that input electronically to DFAS. There are numerous other near-term re-engineering changes we have under review.

In the far-term, re-engineering will be more profound. (Chart 4) This chart provides an overly simple visual aid to understanding our long-term goals. In the long-term, we need to develop standard ways to define information and to share that information so that we can eliminate needless data entry in subsequent offices and rely on the input of the office closest to the task. Once the program manager secures congressional appropriations and enters that data, there is no reason why every

subsequent organization and process cannot electronically borrow that information for its requirements. This chart is meant to illustrate this long-term goal.

Standardize definitions, concepts and practices. The key to this long-term vision is found in the Department's efforts under the Corporate Information Management initiative. I am a strong supporter and advocate for CIM. Our progress to date has been modest, but steady. Certainly we promised more through CIM than could be initially delivered. But we are on the threshold of major changes.

In the financial management area, we have over 100,000 data elements in our 250 plus finance and accounting systems. Detailed data modeling has shown that we will require less than 900 to accomplish the full range of our responsibilities. To date progress on data standardization has been slow. But through concerted efforts, I hope and expect that we will have over 400 of the 900 data elements we require in financial management approved by July 1. It is my goal to have 90 percent approved by the end of the year, and I am modestly optimistic that we will achieve that goal. Once that is achieved, we have agreed on our long-term path. We will have created a common language for our disparate systems to use, or to design a new integrated finance and accounting system.

Design modern finance and accounting systems. I received a great gift from my predecessors when they established the Defense Finance and Accounting Service. I have a tool to use to engineer the needed changes for the future. DFAS has set about the task of streamlining our finance and accounting systems. Where we inherited 18 separate military payroll systems, today we operate only 11, and in 2 years we will be down to 2. The same can be said for civilian payroll systems. We inherited 18 and in 2 years we will be down to only 2.

The benefits from this streamlining are enormous. Today the average payroll clerk services 350 customers. Under our future system, a single payroll clerk will service over 1,500 customers. That is the key to streamlining and downsizing our work force.

We need to do the same in the area of our accounting systems. Here the task is much larger, since all of the existing 161 accounting systems were designed for existing operations, which must continue to operate day in and day out. Our conversion plans here are less well advanced, and present our primary challenge in coming months.

Align financial controls and management incentives. In the past, no one—from senior commanders to supply sergeants—knew or could determine the true cost of the requirements they faced; for example, whether to repair or replace a damaged piece of equipment. Our systems failed to reflect the full cost of doing business. Consequently, individual commanders proceeded with decisions that minimized the cost to their specific organization, even though it quite likely drove up costs overall to the Department. The previous Administration took much needed and heroic actions to correct this problem when they created the Defense Business Operations Fund. DBOF has been a painful reform, however. The initial promises were overstated. Our underlying accounting systems were not up to the task. The reform itself was poorly presented to those most affected by it.

Despite these painful shortcomings, DBOF is working. It has introduced a cost discipline that was absent in our previous system. For the first time, the entire Department is talking about the "cost of doing business".

DBOF has a central problem, however. We have not been able to eliminate unnecessary costs as fast as budgets have been reduced. As a consequence, the ultimate customers continue to bear an increasing burden by higher prices. These higher prices cause them to reduce their demand for those goods and services. The demand falls faster than the depot managers can eliminate costs, resulting in operating losses for the year which must be subsequently recovered through higher prices the next year. This vicious circle is the single largest threat to DBOF. We must take sweeping actions to eliminate these costs if DBOF is to produce its ultimate promise.

The entire DBOF story demands a fuller discussion, and I hope the Committee will invite me to testify again another day on it and all we are doing to make it work.

Practice candor and engender confidence. The final element of our blueprint deals with candor and confidence. We cannot accomplish all these critical tasks without the support of the Congress. We have not always earned that support. And we have made it hard for supporters like you to help us when we have failed to address our problems with the candor they demand. I am convinced the Congress will help us solve our problems if we are honest enough to present them to you and seek your advice and counsel.

This Committee has a distinguished history in pointing out the Department's shortcomings in the area of financial management. Your sincere efforts were fre-

quently rewarded by cold silence. I hope you believe that we are now set upon a different course. We are anxious to solve our problems and we seek your support in our task.

I do not pretend we have found the only way to solve our problems. I welcome any advice and direction you can give us. I would only ask that you not burden us with tasks which do not solve our underlying problems.

Conclusion

Mr. Chairman, I do sincerely appreciate the opportunity to testify before you today. I do so on behalf of the 46,000 civil servants who work in the financial management area. We owe them more than we have given them to do their work. They are carrying the burden every day for the flawed systems we have given them. This committee has been correct to point out our failings over the years. I now ask that you become our sponsors for change.

Thank you, Mr. Chairman. I look forward to answering your questions.

IMPACT OF VERTICALLY - ORIENTED STAFF ORGANIZATIONS

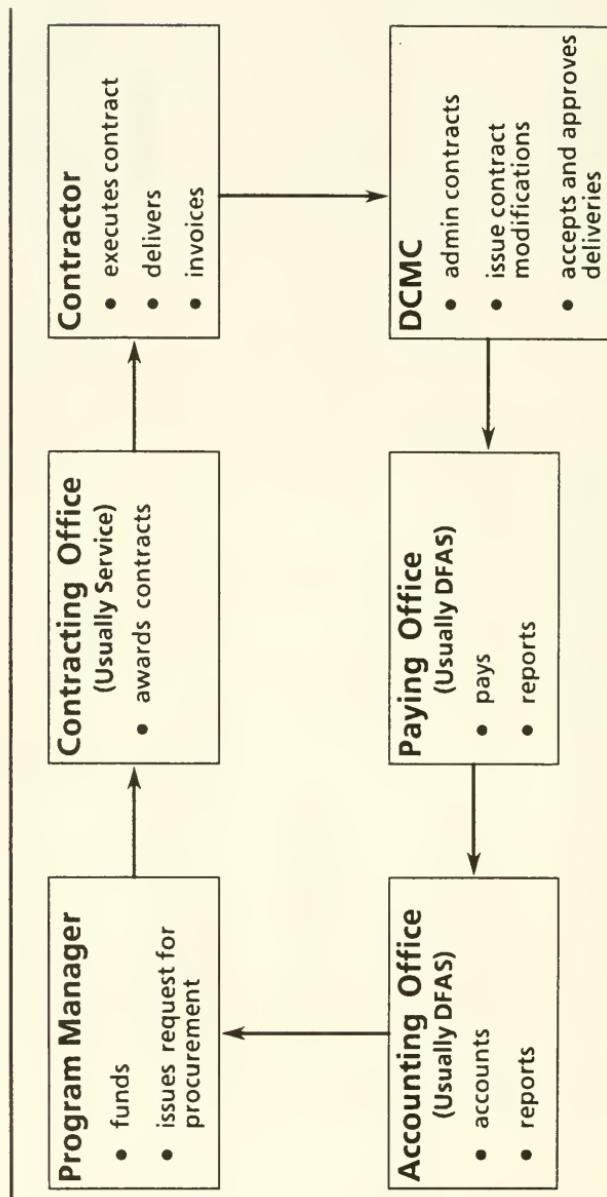
- Complicated Business Practices
- Frequent Performance Failures
(for example, unmatched disbursements)
- Most Systems useful only Inside a Single Staff Organization
- Redundancy/System Isolation
 - Limited Automated Interface between Systems
- Lack of Common Understanding on Terms, Concepts and Procedures

Contract Payments Process

(Responsibility Sequence)

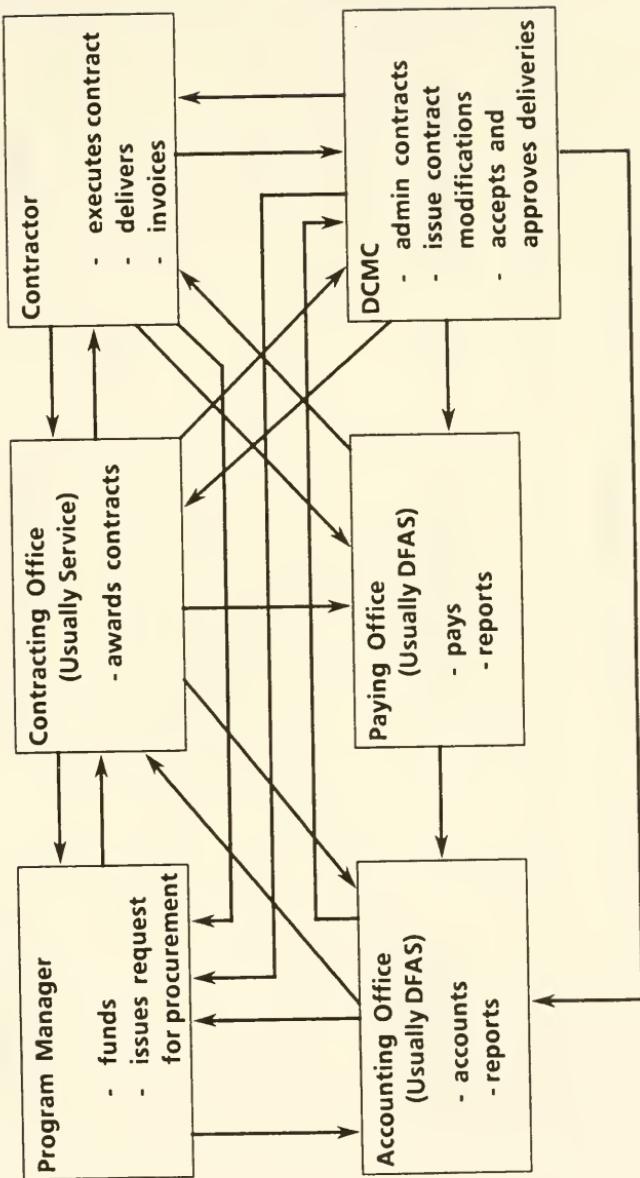
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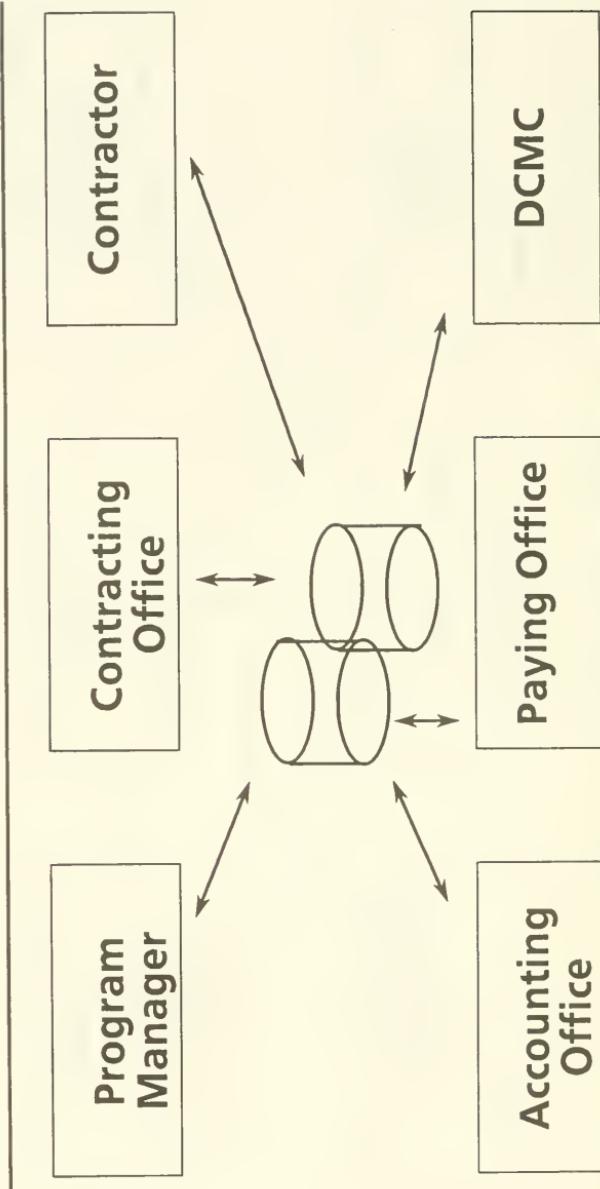
Contract Payments Process

(Paper Flow)



Contract Payments Process

(Future Vision)



[Whereupon, at 12:36 p.m., the Committee was adjourned.]



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